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PART 1: OVERVIEW

A. Background

Recent dramatic changes in Serbia marked major advances for US foreign policy goals. The democratic removal of an autocratic president and the apprehension of a major indicted war criminal were substantial successes in themselves. Yet, it is the subsequent improvement of human, political, and economic freedoms that provides tangible benefits for the people of Serbia and the democratic world.

As the social, political, and geographic crossroads between Western and Eastern Europe, Serbia occupies the key strategic juncture in the Balkans. Serbia has been the locus of instability in the Balkans since the end of the Cold War. After a decade of military and civilian involvement in seeking peace in Southeastern Europe, the United States, NATO, the United Nations, and the European Union all have an enormous stake in stabilizing Serbia and the region. The United States continues to have a compelling national interest in securing the sustainable political and economic stability of Serbia; this includes the establishment of a secure, democratic, governing framework in which political, social and economic rights are respected and conflict is channeled and resolved through legal structures.

The Governments of the Federal Republic of Yugoslavia (FRY) and the Republic of Serbia have made significant strides in laying the foundation for democratic consolidation and economic transition, but significant challenges remain. The fragile nature of the FRY and Serbia's domestic political landscape, continuing uncertainties regarding future governance arrangements with Montenegro and Kosovo, and persistent ethnic tensions, make USAID's continued assistance to deepen and broaden Serbia's fledgling democracy critical.¹ It is essential that the citizens of Serbia begin to quickly to receive sustainable economic, as well as political, benefits from the break with the country's authoritarian past. Otherwise, the Serb people will be increasingly susceptible to pressure to reject a transparent and inclusive democratic system and to renew nationalistic calls that inflame ethnic, religious, and cultural differences.

USAID's past activities included SEED and OTI programs that directly supported resistance against Slobodan Milosevic's autocratic regime and supported the process of democratic change that led to the electoral defeat of his regime. USAID also provided humanitarian assistance and P.L. 480 food aid during this difficult period.

USAID's Interim Strategy is based on three pillars: democracy and governance; a large civil society program aimed at fostering democracy at the local level; and broad-based economic policy reform that supports sustained growth of the private sector and economic integration with Europe.

This Interim Strategy covers USAID assistance to Serbia and the Government of the FRY. An Interim Strategy for Montenegro will be submitted in the spring. Due to its special UN

¹ In March 2002, the governments of Serbia and Montenegro concluded an interim agreement that preserves a federal structure for the next three years. This agreement, mediated by the EU, must still be ratified by the federal parliament (it was ratified in both republic parliaments in April 2002). If the agreement is fully implemented, the name of this federal state will change to "Serbia-Montenegro." As the name has not officially changed, we have continued to use "Federal Republic of Yugoslavia" (FRY) for purposes of this strategy.

administered status, Kosovo has a separately submitted and approved USAID Interim Strategy.

B. Economic Profile

Yugoslavia has endured a decade of economic instability and contraction induced by autocratic and distortionary economic policies, by manipulative domestic political parties and by sanctions which severed market and trade links. Economic activity contracted an estimated 60 percent between 1989 and 1999², with living standards declining steadily over the period, as unemployment and inflation rose and the wage base and household incomes were eroded. Further contraction of the industrial base in 2000³, lowered factory wages to 250 – 300 DM/month, and per capita GDP now hovers at levels prevailing in the late 1940s.⁴ Due to the contraction of the formal sector, bank and non-bank “gray” market activity has increased significantly and is currently estimated at 40-50 percent of GDP.⁵

Consumption has been sustained through undeclared sources of gray market income, the “dissaving” of hard currency “mattress money” estimated at \$4-5 billion (\$400-500/capita)⁶, and through remittances from the Serbian diaspora.⁷ Rural households have been unusually hard-hit, particularly in local economies dominated by one or few large state-owned enterprises. Economic restructuring and privatization are underway, as a result unemployment will inevitably rise and social and political pressure will increase.

Investment virtually ceased during the decade of the 1990s. Industrial plant and equipment are dilapidated, due to asset-stripping and neglect, and physical infrastructure is in similarly poor condition. Attracting investment in enterprise and infrastructure demands much-needed reform of the legislative and judicial systems. The government has demonstrated considerable will to draft and ratify new laws, though uncertainties regarding implementation and enforcement are among the most significant impediments to growth and investment in Serbia.

Serbia suffered significant power outages during the winter of 2000-2001 and is committed to energy sector reform. Reform however, has meant an unpopular doubling of electricity prices in 2001, which has spotlighted criticism against the Ministry of Energy, already the target of massive miners’ strikes in the summer of 2001. For political reasons, the government is committed to “keeping the lights on” during the winter of 2001-2002, but it will do so at significant expense.

² “Economic & Financial Outlook—Eastern Europe”, Deutsche Bank Research, January 22, 2001.

³ *World Development Report*, World Bank, 2000/2001 and “Federal Republic of Yugoslavia: Request for a Stand-By Arrangement”, www.imf.org, June 2001.

⁴ “Salvaging Yugoslavia”, *Business Central Europe*, November 2000.

⁵ “Financial Needs for Macroeconomic Reforms and Reconstruction of Post-Milosevic Serbia—Executive Summary”, www.g17plus.org.yu, 2001, and “Economic & Financial Outlook—Eastern Europe”, Deutsche Bank Research, January 22, 2001.

⁶ One meeting reported that the NBY thinks there are DM 2-4 billion-equivalent held outside the banking sector.

⁷ Current estimates of broad money suggest that sizeable holdings exist outside the banking system in DM, US\$ or other hard currencies as a hedge. Bundesbank estimates go as high as DM 9-10 billion and were calculated in an effort to ascertain DM held outside of German markets that would be converted to Euros in the future. The IMF confirmed the Bundesbank estimate.

The National Bank of Yugoslavia has maintained a stable exchange rate, and inflation, though high, is declining. However, imminent bank and enterprise liquidation will boost unemployment, reduce economic activity, and thus further threaten already shallow public confidence and support for reform.

In July 2001, donors pledged \$1.2 billion in assistance.⁸ Having secured almost 70 percent debt reduction of Paris Club obligations, the prospects for London Club reduction are favorable, as a result Serbia may have a foundation upon which to build. Consolidated and deliberate support is critically needed to sustain the ongoing structural reform of economic and legislative infrastructure and support economic revitalization and employment creation measures.

C. Political Profile

In September 2000, the Democratic Opposition of Serbia (DOS) ousted Slobodan Milosevic's Socialist Party of Serbia (SPS) in a landmark electoral victory. Despite this dramatic political transition, Serbia's democratic future is far from secure. Its leaders face the challenge of building broad consensus on a range of critical social, economic, and political changes necessary to move the country towards the Euro-Atlantic community, the free market, and a global community of democracies. The new government must also demonstrate that it can deliver a reform package that improves citizens' lives after a decade of economic decline. Further, it is essential that both government and non-governmental institutions develop constructive frameworks for addressing lingering ethnic, religious, regional, and economic conflicts, through peaceful, legal means, in order to avoid a regression into the defensive, violent nationalism of the previous decade.

In the face of this tremendous and difficult drive for transition, the remarkable, positive political changes that have taken place over the last year receive less attention than they deserve. Serbian society and political life are vastly more open than they were prior to September 2000. Despite virtually no personnel turnover, police and military forces have largely respected the change in government. Media and NGOs enjoy more freedom to operate -- one of the new Government's first actions was to repeal an extremely repressive media law in place during the previous regime -- though both media and NGOs face constraints in the continued lack of a positive legal framework for their operations. The government has exercised tolerance in permitting the opposing parties (SPS and JUL) to continue to operate freely. Finally, though often criticized for not defining and implementing a clear legislative agenda, the Government has made progress on enacting critical economic legislation, most notably in the fiscal arena.

At both the federal and republic levels, the new Government, much of it drawn from the ranks of civil society, is struggling to establish the legal and institutional framework for governance along democratic, market-oriented lines. The Democratic Opposition of Serbia's (the Government) 18 constituent parties are far from united in their approach to these crucial reforms. Political conflicts frequently manifest themselves as infighting among DOS party leaders, most notably and publicly between FRY President Kostunica and Serbian Prime Minister Djindic. It is unclear whether DOS will hold together through the next round of elections (Kostunica's DSS party has withdrawn from Republic government structures), which could take place as early as fall 2002, and DOS infighting dominates political

⁸ "Federal Republic of Yugoslavia: Request for Stand-By Arrangement", www.imf.org, June 2001.

dialogue. DOS leaders face the challenge of moving reforms through largely unreformed bureaucracies. There also is an urgent need to unravel a Byzantine system of pervasive grand and petty corruption that hinders economic development, depresses citizens' rights, and leads to extremely inefficient resource allocation.

The issue of the future status of the Yugoslav federation consumed enormous political energy over the past year. In March 2002, the governments of Serbia and Montenegro concluded an interim agreement that preserves a federal structure for the next three years. If fully ratified (it must still be accepted by the federal parliament), this agreement will effect changes in federal ministries, change the name of the federal state to Serbia-Montenegro, and prompt elections at the federal and possibly the republic level. The agreement has diffused tensions arising from this long unresolved question; however, it has also caused significant political fractures in Montenegro's coalition government. It is unlikely that the agreement will resolve the question of Montenegrin independence for the long-term, but it buys vital time for the future of the state to be determined and reforms to proceed in the meantime.

The question of dealing with the past is also of central importance in shaping the FRY's post-Milosevic national identity. Serbian society is far from united regarding how the country should confront its role in the regional conflicts and atrocities of the past decade. Milosevic was transferred to the Hague in July 2001, but publicly indicted war criminals remain in the region. An indigenous, federal-level Truth Commission has been established, but is inactive. Attitudes towards the ICTY's efforts to bring Balkan war criminals to justice range from support, to anger, to apathy. Other pressing political issues include labor unrest in the face of continuing economic stagnation and rising unemployment, a push for greater autonomy by political forces in Serbia's Vojvodina region, ethnic and religious tensions (exacerbated by economic hardship) in Southern Serbia, the question of Serb participation or boycott of elections in Kosovo, and the effect of these elections in shaping Kosovo's and the FRY's future political status.

Serbia's civil society and opposition political parties are no longer united by a single, all-consuming issue, as they were prior to October 2000 by the drive to oust the Milosevic regime. They are now reconstituting themselves as advocates for more effective governance, protectors of citizens' rights, and sources of assistance to help ameliorate the impact of social, political, and economic reforms. Even among groups with common interests, networking and collective action remains underdeveloped. As of November 2001, a more supportive draft Republic law governing NGO operations had not yet passed.

Independent media are similarly hamstrung by the lack of a supportive legal framework. Radio/TV B-92, a central player in the DOS election victory, has not been granted a license to broadcast outside of Belgrade, hindering its ability to develop competitively. The current rules favor those stations granted nationwide licenses during the Milosevic era through a non-transparent, politicized process. A few large media players, some with shady ties to the previous regime, continue to dominate the airwaves. Independent print media suffer from falling readership. Further, state broadcaster RTS has retained its privileged position. Once the voice of Milosevic, it is now increasingly the voice of the new government. These developments have combined to depress free and open competition in the media sector, as well as the quality of information that citizens can access.

In some government institutions, reform-oriented ministers have been effective in advancing needed legislation and are making strides at reforming their institutions. Coordination, even

among these forward-looking institutions is very weak however, and there is no broad strategic plan for the reform process as a whole. The legislative process is sometimes characterized by abbreviated or non-existent public debate. At times, public comment has been scrapped entirely in the wake of back-room deals between parties on key legislation -- this was the case in the recent enactment of a long-awaited package of laws on the courts.

The judiciary has not yet emerged as an independent force for institutionalized, just conflict resolution. The legislature is institutionally weak and functions as a rubber stamp for the executive. Milosevic-era recentralization continues to affect local governments, which lack sufficient authority and fiscal autonomy to deliver decentralized, democratically-oriented local governance. A proposed law on local governance that could serve as the first step in establishing a framework for decentralization only recently passed, leaves some significant questions unanswered, and remains to be implemented.

In sum, Serbia faces significant hurdles if it is to consolidate democratic gains, continue to advance political reforms, address lingering trigger-points for conflict and move towards Euro-Atlantic institutions. USAID's democracy and governance strategy is designed to assist both government and non-governmental organizations in building a broader, more solid consensus for democracy, respect for citizen's rights, and peaceful conflict resolution. It also proposes sustained attention to major governance issues to ensure that Serbia's institutional structures are equipped to serve citizens, incorporate their participation, protect their rights, channel conflicts peacefully and legally, and advance democratic and economic reforms as efficiently as possible. At the same time, it calls for continued, meaningful support for the participation of citizens in decision-making affecting their daily lives.

D. Conflict

We have identified a number of potential triggers for conflict that merit continued monitoring, as well as possible adjustments to our strategy.

Dealing with the Past. Serbia has only just begun to examine the events of the past decade. Many of its citizens and leaders would prefer not to do so at all. State-owned broadcast media is still the primary source of information for many Serbs and quality investigative reporting regarding Serbia's role in regional wars and atrocities is largely unavailable on these networks, which were actively used by the previous regime to fuel nationalism and inflame the ethnic/religious hatreds that fueled the wars in the first place. Academic opinion on the value of confronting the truth in post-conflict societies is divided; in Serbia's case, however, there is a strong push by human rights organizations to examine the past and deal with its consequences. USAID is supporting civil society initiatives in this area, and will continue to do so over the life of the strategy. FRY and Serbian government institutions, however, have taken only tentative steps to begin the process of investigating and dealing with the past. An indigenous Truth Commission has been established, but so far is fairly inactive.

Cooperation with the Hague is still viewed by the international community as inadequate. Facing a 2001 donor conference tied to a massive aid package to fuel the FRY's economic recovery, the Republican PM agreed to Milosevic's extradition; however, Serbia is in the embarrassing position of having an indicted war criminal (Milutinovic) as its president. Other prominent suspects wanted for indictment in the Hague are also still at large. For this reason, the US Congress has conditioned aid to Serbia on future cooperation with the Hague.

This issue is included as a conflict trigger, because without incremental progress in confronting these issues as a culture and government, Serbia's democratization process is threatened.

USAID's DG programs are helping to advance the issue of truth and reconciliation by supporting NGO efforts to investigate war crimes and abuses of human rights (committed by Serbs and against Serbs), and to bring the perpetrators of these crimes to justice through advocacy on behalf of victims. Rule of law programs focus on developing the judiciary as an independent forum for just conflict resolution. Independent media support helps to ensure that objective information about Serbia's past, present and future is more available to citizens. The media program is also helping to demystify the Hague process by supporting a rotating group of Serbian journalists from both state-owned and private media in covering the Hague.

Lingering Regional and Ethnic Tensions/Rights Issues. One year after the 2000 elections that brought DOS to power, Serbia is at peace. Lingering tensions between the center and certain regions, and between ethnic and religious groups in others, have the potential to undermine this relative calm, thus destabilize the country, and/or to redefine Serbia's national borders and identity. In parts of southern Serbia, Albanian minorities face employment discrimination and other violations of their human rights, are not sufficiently represented in government and in the civil service, and do not yet have a strong voice in civil society or in the media. There is an uneasy balance between the majority and minority communities in these areas that is subject to disruption by events in neighboring regions and countries. USAID's programs address these issues by building bridges between ethnic and religious communities by bringing groups together on concrete community improvement projects, by fostering discussion through NGO initiatives, by support for a diverse independent media, and by sponsoring programs that address issues such as employment discrimination through support for legal aid.

Kosovo's future status also has important implications for Serbia. Now UN-governed, Kosovo's eventual transition to indigenous leadership (likely under a majority Kosovar Albanian government) will have significant implications for Serbia. November 2001 elections in Kosovo provoked a debate between the UN and the leaders of various Serbian factions in Kosovo, and of Serbs displaced by the war, both there and now resident in Serbia. Serb leaders were divided over whether Kosovo Serbs and IDPs should participate in these elections; however, international pressure on federal and republic structures eventually carried the day. Kosovo Serbs, in Serbia, were quietly encouraged to take part and guaranteed protection were they to do so. No programmatic adjustments are warranted at this time to address issues arising from this situation. However, it merits continued monitoring as an important factor in Serbia's political development.

An interim agreement that preserves the basic outlines of a Serbia-Montenegro federal arrangement was concluded in March 2002. This agreement defers a Montenegrin referendum on independence for three years and in effect allows time for the federal and republic government to advance reforms in a relatively more settled political atmosphere. The agreement has yet to be fully ratified, however, and fundamental issues relating to the eventual outlines and scope of the federal state remain unresolved. The agreement will likely prompt elections at both the federal and republic levels in the near term. USAID will respond to these ongoing developments through its political process activities in both Serbia and Montenegro.

In Serbia's Vojvodina region, voices for greater autonomy, and even independence, are growing louder. The region had greater autonomy in the Tito era -- Milosevic revoked this special status. Many in this multiethnic region favor a return to decentralized regional governance. USAID supports NGOs and communities in this region, through its civil society and community revitalization projects. Numerous other USAID activities also serve partners in this area. No programmatic adjustments are recommended at present; however, Vojvodina's future status merits continued monitoring. We will also continue to monitor developments in the Sandzak region of Serbia, where there is a substantial Muslim community that was suppressed under the Milosevic regime and has a still limited voice in civil society and policy making.

Possible Police/Military Unrest. Serbian and federal police and military services are largely unreformed. There has been no significant change of leadership or personnel, and while the services have largely served the new Governments peacefully, there are indications that this could change. In November 2001 there were armed demonstrations of "Red Beret" special Republican forces. These units were established by the SPS as Milosevic's personal guard, and led the charge in some of the most heinous attacks on neighboring Croatia and, probably, Bosnia during the war. The Red Berets took to the streets to protest what they perceive as a lack of clear criteria regarding Hague arrests and extraditions. Although he was criticized by FRY President Kostunica, Serbian PM Djindic's firm stance towards the Red Berets (he demanded that they either faithfully serve the government or resign) appeared to diffuse the situation, at least for now.

Police and civil/military reform are sorely needed in Serbia. At present, USAID believes that its rule of law efforts are more appropriately focused on the civilian side of the equation, especially within the unreformed and uninformed judiciary. We are prepared, however, to cooperate with other US agencies as appropriate and as permitted by our policy and governing legislation on this important element of Serbia's democratic transition.

Shifting Political Dynamics. DOS' future status is an open question. The 18-party coalition was never "built to last" in its combination of parties with widely diverging leaders and platforms. DOS' purpose in defeating SPS and JUL, however, was served. Its shaky unity has affected Serbia's political scene strongly since the coalition took power. FRY President Kostunica (DSS) and PM Djindic (supported by the remainder of DOS) dominate DOS. Feuding between the two leaders and their factions has slowed the reform process.

Public opinion is divided as to whether DOS should hold together, but united in an expression of disgust with the unproductive bickering between DOS party leaders. This infighting fatigue could negatively affect both parties in any future elections. Under this strategy, USAID proposes continued assistance to democratically-oriented parties, whether part of a unified DOS or as independent actors, because it is essential that these parties continue to be assisted in developing broader and more solid constituencies, engaging citizens in policy, and communicating policy platforms and decisions more effectively.

We have included this issue as a conflict trigger because atomized support for a fragmented group of democratic parties, in the absence of a coalition, could in a worst-case scenario lead to the return of far-left or far-right political forces. This would have clear implications for our program, in that many of our activities depend on the engagement of democratically-oriented leaders in the reform process.

Social Impact of Economic Reform. Government action is needed to ensure that economic reforms in Serbia are complemented with attention to the social consequences of reform. Inadequate attention to social safety-net issues, such as pension and health care system reform and benefits for the unemployed, could derail public support for reform and fuel calls for a leadership change.

USAID's economic strategy seeks to rapidly provide tangible economic benefits of reform and turn around the stagnant economy by front-loading assistance to the pro-reform government in order to motivate the needed structural and technical changes. Legal and judicial reform, imperative for the resolution of a bankrupt banking system and insolvent state sector, are among the most important initiatives under this strategy. USAID will assist in enhancing and strengthening commercial legislation, and will train court judges to adjudicate commercial cases and protect security and investor interests. This effort is essential to building a strong business climate that will promote growth, create jobs, and thus mitigate the potential for conflict arising from painful economic reform and restructuring.

In addition to its efforts to ensure sound structural reform and economic revitalization, USAID's programs support civil society engagement in partnerships with government to address social issues. Through the Community Revitalization through Democratic Action (CRDA) program, we are helping to institutionalize citizen participation in solving most immediate problems they face, such as access to basic public infrastructure. USAID's other civil society activities will complement CRDA by strengthening NGOs as service-providers that complement and enhance available public services. Finally, the Mission's local government initiative will help to sustain more effective planning and service delivery over the long-term by helping local governments implement more efficient and inclusive systems and processes.

Unmet Expectations. Popular perceptions regarding republic and federal government performance in managing Serbia's political, economic, and social transition are extremely critical to the country's continued forward movement. Polling data indicate that "swing" voters (who fall somewhere in the middle between angry, disaffected supporters of the former regime and primarily young, pro-reform voters) are increasingly dissatisfied with the pace of economic transition. This dissatisfaction has not yet reached a critical mass of unmet expectations that would result in a return of the far left or right; however, it merits close monitoring over the life of the strategy.

USAID is supporting NDI and IRI's efforts to monitor public opinion through polling and focus groups. Elements of these polls are shared with party leaders to identify areas where focused attention to better policy coordination and outreach will help to solidify support for reform. Results are also communicated widely within the USAID Mission, shared with the Ambassador, and discussed with USAID partners engaged in economic reform support to ensure that our support for reform is focused on the issues of greatest importance to Serbia's development, and of greatest concern to citizens of Serbia. USAID will continue to support monitoring of public opinion as a critical element of its program. The core USAID program and OTI coordinate closely to address this potential "trigger"-- OTI is engaged in an initiative to accelerate the pace of reform in selected areas to help meet popular expectations and shore up support for democratic and economic transition.

Potential for U.S. military engagement. A deterioration of circumstances in the areas around Serbia where thousands of U.S. troops are present (BIH and Kosovo) would profoundly affect USAID's proposed Interim Strategy. Any adjustments that might be needed, however, would be determined at that time.

E. Other Donor Support

The international financial institutions (IFIs) and other bilateral donors are actively involved in providing assistance to FRY/Serbia's democratic and economic transition. A summary of donor activities and USAID coordination with these programs is presented below.

Economic Stabilization, Recovery and Transition

At the July 2001 donor conference, \$1.2 billion was pledged, a significant portion of which was for economic reform and reconstruction. In addition to the multinational donors (IMF, the World Bank, the EBRD and the EU's European Agency for Reconstruction -- EAR), the primary bilateral donors in the FRY/Serbia are USAID, DFID/UK, GTZ and KfW/Germany and DEG/Netherlands. Within the Serbian government, the Ministry of International Economic Relations (MIER) is responsible for donor coordination, taking the lead on EU Accession, commercial law reform, foreign investment, and public education/media relations. USAID, the IFIs and bilateral donors are working closely with this Ministry in a number of areas. Formal and informal donor coordination meetings, organized by different donors and IFIs are held regularly to discuss general assistance issues, as well as specific topics, e.g., commercial law reform.

As described above, the focus of USAID's economic growth and structural reform program activities in Serbia is in the following areas: banking, WTO accession, commercial law, judiciary, mortgage finance, and enterprise privatization. The U.S. Treasury is supporting reforms in financial crime investigations and tax administration. While the IFIs and other bilateral donors are involved in many of these areas, USAID plays a leadership role or is providing the lion's share of the necessary technical assistance in many of them, and closely coordinates with all of them. This is particularly true for banking, WTO accession, and commercial law.

The EBRD, the EAR and other bilateral donors have also committed significant funds to SME development activities, many of which have already been implemented. The Micro Finance Bank (capitalized by the EBRD, Commerzbank, and others) began operations in April and has made over 3,000 loans to micro and small firms. SEED funds were transferred to the EBRD to fund TA for MFB borrowers. The EBRD has committed around \$20 million to SME development to help establish an SME agency and law, setting up business advisory centers and providing an SME credit line through local banks. Business advisory centers have already been established in six major Serbian cities, and two local banks have been selected for credit lines. Other bilateral programs have committed to providing credit lines, equity support for joint ventures, and other consulting support for SMEs.

Democratic Transition

There is a large array of donors engaged in democracy and governance activities in Serbia. Key players include the Open Society Institute (OSI), the Organization for Security and Cooperation in Europe (OSCE), the UN Development Program (UNDP), the European

Agency for Reconstruction (EAR), and bilateral assistance programs managed by the Swedish, Canadian, Dutch, Norwegian, and the British. The amount of donor funding and engagement varies widely according to the DG issue or sector being addressed.

Civil society, for example, is a major area of support for virtually all donors present in Serbia. Other sectors, such as independent media, attract resources from a few key donors (in media's case, Press Now -- funded by the Netherlands, OSI, and USAID are the key players). Rule of law is also heavily patronized, with many donors beginning to commit resources for judicial training and capacity building, and others exploring other aspects of ROL, such as support for improving the legislative process. Political party support and trade unions attract relatively few donor resources. USAID is by far the lead donor in these two areas.

Coordination also varies widely. Most donors agree that coordination of DG resources was extremely strong prior to the elections, when institutions shared the common objective of helping their partners bring about a very dramatic democratic change. Since that time, coordination has become more diffuse. This is particularly noticeable and where the most donor resources are being brought to bear (in civil society and rule of law). Over the life of this strategy, we will seek, together with other donors, to revive effective coordination in key areas including civil society and independent media.

Donor coordination regarding rule of law programs is a work in progress. A commercial law working-group has been established, and meets regularly. Regarding legal sector reform writ large, an effective overall coordination mechanism has yet to emerge, although OSCE has been taking the lead in coordinating efforts on certain special projects, notably on a proposed "bridge fund" for increasing judges salaries and current efforts to establish a judicial training center. A number of the donors, including USAID, have not been completely satisfied nor agree with these efforts to date, and there clearly is a need for a mechanism to improve donor information exchange and coordination. USAID maintains close contact with individual donors on this issue, and working with our donor counterparts, are exploring ways that ROL coordination can be improved.

F. Corruption

A recent survey of corruption in Serbia confirms that citizens of Serbia view endemic corruption as one of the country's most serious social problems after poverty, political instability and crime. Perhaps more significantly, citizens believe that more than three-fourths of all state employees participate in corruption. Given corruption's deep historical roots in Serbia and an environment all too conducive to its growth, no aspect of political, economic or social life in Serbia is safe from corruption's tendrils.

The strategy for combating corruption advocated here is a holistic one that calls for four types of interventions across the entire range of programs and activities implementing the Mission's Strategic Objectives.

Transparency

Because corruption flourishes in an atmosphere of secrecy and information withholding, *transparency in government* and *transparency in the private sector* (as an aspect of corporate governance) are at the center of the Mission's strategy of integrating anti-corruption interventions into its entire portfolio.

Prevention

Increasing transparency is a necessary but insufficient component of a strategy to combat corruption. USAID's strategy will also concentrate on *prevention*-- the systemic reform of institutions so as to decrease opportunities for corruption. By subverting and replacing perverse corrupt incentives with incentives that promote economy, efficiency, effectiveness, disclosure and accountability, systems of integrity replace their corrupt opposites.

Awareness

In addition to *transparency* and *prevention*, the strategy supports interventions that promote awareness of the nature, extent, forms, and adverse consequences of corruption as well as the opportunities for reform. The objective is to move beyond general discussions of these evils of corruption to dissemination of specific action- inducing information by the media and advocacy groups that decreases the public's tolerance for corruption and shows the pathways to change.

Enforcement

No anti-corruption strategy that excludes *enforcement* is complete. USAID's strategy, however, looks at enforcement broadly, rather than limiting it narrowly to the enactment and enforcement of criminal and penal laws. USAID's approach includes an array of civil, administrative, judicial and other mechanisms that promote the rule of law. These include institutions of internal and external oversight and control, ombudsmen, self-regulating organizations, and a truly independent and professional judiciary.

Implementation Approach

Transparency, prevention, awareness and enforcement interventions will be designed and implemented so as to reduce the classic set of conditions that foster the emergence and spread of corruption: high monopoly power; high discretion; and low accountability on the part of those with control over the allocation and distribution of resources. First, the monopoly power of officials will be decreased through deregulation, privatization, regulatory simplification, and reduction of unilateral control over the allocation and distribution of licenses, permits, contracts, concessions and public services. Second, the unfettered discretion of officials will be replaced by transparent rules of the game and uniformly applicable standards. These include internationally recognized principles of public procurement, international accounting and auditing standards, and other best practices (as enshrined in international conventions, European Community directives or other otherwise promulgated or demanded or expected by international donors, lenders, investors and other institutions). Along with less monopoly power and less discretion, accountability mechanisms will be enhanced. This will be accomplished through: (1) increased transparency by more access to information and greater dissemination of relevant information by those bound to account for their actions; (2) application of internal and external controls and oversight; and (3) enforcement of new and reformed public sector and private sector laws, implementing regulations and procedures.

USAID/Serbia's DG strategy promotes greater transparency and accountability at all levels of government, and builds societal support for combating corrupt practices. Civil society

support will include grants and capacity-building for NGOs working to encourage more open, efficient government through advocacy and government-NGO partnerships, and for programs that encourage greater respect for democratic values by raising awareness on corruption issues, promoting equal application of the law, and encouraging respect for human rights. The rule of law program focuses on increasing independence in the judiciary, a prime locus of corruption under the previous regime. Judicial training and capacity-building includes attention to institutionalizing ethical codes of conduct and standardizing judicial practices with regard to both criminal and civil cases. USAID's independent media program helps to increase the flow of objective information available to citizens through a vibrant, competitive free press. Support to independent trade unions engages workers in critical decisions regarding privatization and economic reform, thereby reducing the potential that economic policy will be made in a vacuum, without attention to social impacts. Similarly, USAID-supported assistance to democratically-oriented political parties helps develop a new generation of leaders that recognize the value of opening the policy process to greater public input and scrutiny, and of communicating openly with constituents concerning key policy decisions. Opening the policy process reduces the potential that decision making will be left in the hands of a potentially corruptible few.

The Mission's local government activity will encourage transparent, efficient, decentralized government and greater fiscal autonomy at the local level, while helping municipal officials to implement sound financial management systems and practices to manage these new responsibilities effectively. Finally, USAID's Community Revitalization through Democratic Action (CRDA) program promotes openness in local-level decision-making regarding key community priorities by institutionalizing a participatory process at the level of governance that most directly impacts citizens' daily lives.

The Mission's economic portfolio comprises activities that directly and indirectly seek to combat financial crimes and corruption. Transparency, prevention, awareness, and enforcement are cornerstones, included in a variety of combinations in all activities. Transparency is among the principal objectives of the initiative to advance and implement international accounting standards (IAS) for all purposes in all business. Transparency is the dominant paradigm being advanced by the government in bank and enterprise privatization. All tenders are conducted according to open and competitive procedures that are being implemented by USAID-supported technical advisors in both instances. In a more nuanced definition, transparency is also the goal of increased public participation in policy, legislative and regulatory development and decision-making. Such participation is fundamental to existing and future activities seeking to enhance the development, implementation, adjudication and enforcement of commercial law.

Sound, prudential and efficient oversight is critical to a developing and increasingly complex financial and economic system, such as that in Yugoslavia. After a decade of authoritarian economic management, most regulatory bodies were substantially weakened or were disbanded. USAID will work actively to rebuild or strengthen those institutions central to preventing financial crimes and corruption. Target institutions include the National Bank of Yugoslavia, which through its supervisory functions ensures the safety and soundness of the financial system. Other regulatory institutions that may be the object of USAID assistance include the Securities Commission, the Insurance Commission and prospectively, a pension and health benefits regulator. USAID will also work to found non-regulatory bodies that also play roles in preventing corruption. Currently, these include the Anti-monopoly (anti-trust) Commission and the Public Procurement Agency.

In conjunction with efforts through governmental institutions to prevent crime and corruption, focus will also be directed at the private sector, including the involvement of a more aware public at large. In addition to the adoption of improved accounting standards that promote fair and regular disclosure, USAID will seek to promote a more robust set of business ethics, internal governance, and internal audit/risk management behaviors that improve corporate governance. For the FRY, corporate governance will also include improved practices relevant to a developing population of shareholders.

A necessary corollary to competent external regulation and improved internal controls that prevent and detect questionable behavior, is strengthened enforcement. USAID is working to improve enforcement in judicial as well as administrative bodies. USAID will work the commercial courts to train judges to better adjudicate and enforce commercial law. Early activities are already bearing fruit as evidenced the by court-ordered closure of several banks found guilty of financial crimes. USAID is also working with the U.S. Department of Treasury to strengthen the competencies of the Ministries of Finance and of Interior in combating crime and corruption directly.

G. Gender Considerations

Attention to gender results in better-targeted and more effective activities. In addition, new Agency directives call for the integration of gender issues in all new planning and procurement processes. “Gender” is not another word for “women.” It means examining the constraints and opportunities for both men and women, particularly as they may differ.

The beginning of 1990s in Serbia was marked by emerging nationalism and a revival of retrograde political ideas that eventually resulted in a series of wars in the Balkans. Both men and women suffered from the economic, political, and social effects of the conflicts, but often in different ways. Although these changes affected both men and women, women were disproportionately affected as society pushed women toward a higher level of dependence on patriarchal family structures and traditional, often retrograde values. A declining economy, unequal access to employment, and falling wages created further obstacles to women's full participation in social, economic and political life.

In many areas, women’s participation in socio-economic and political life has deteriorated. Women have continued to be active in the labor market (40.5% of the 2000 total).⁹ However, women’s unemployment rates are higher than men’s, and women comprise the majority of the long-term unemployed.¹⁰ The number of women in politics is relatively small. As of 2000, women held 7% of seats in the lower house of parliament and 3% in the upper house. These percentages give Serbia a rank of 88 among 179 countries, close to Bosnia, Macedonia, Uzbekistan, and Georgia.¹¹ Sexual trafficking is also a major issue. Because of the severity of the problem, the recent USG Trafficking Report ranked Serbia in “Tier 3,” the most problematic category.

Under the Milosevic regime, men found themselves increasingly incapable of fulfilling the role defined for them by an increasingly authoritarian government. This resulted in a high

⁹ World Bank, 2000.67

¹⁰ International Helsinki Federation, *Women 2000: An Investigation into the Status of Women in Central and South Eastern Europe and the NIS, 2000.*

¹¹ Women in Parliaments (website: www.ipu.org).

level of both inter-personal and intra-personal conflicts, resulting in, among other things, increased levels of family violence that remain high. During the 1990s, men were forced to join military and/or paramilitary forces and perform acts that were condemned by the human rights community. Individual objections to the legality, necessity or justification of such a policy were never taken into account. Conscientious objection was not recognized as a legal instrument of voicing opposition to conscription. Organized state repression and increasing authoritarianism crushed voices of dissent. This prompted 300,000 young and educated people, more men than women, to leave the country, leading not only to the disruption of families, but also to a major brain-drain.

The move towards democracy in 2000 has not brought about a complete change in civil society, although some changes are apparent, particularly those related to political and media freedom. Gender issues impact prospects for all other aspects of democratic transition, because equal participation of men and women is essential to ensure consensus for reform.

Within the Mission's current portfolio, gender is most fully integrated into democracy and governance activities. Rule of law assistance, for example, has specifically addressed legal issues related to gender, such as family law and employment discrimination. Political party and civil society support includes programs designed to increase women's leadership in the transition process.

The economic growth and CRDA programs also seek to include women as fully as possible in all decision making council and project activities. We recognize, however, the need to increase attention to gender across our portfolio. To that end, we intend to undertake a full gender assessment in year one of the strategy.

H. USAID/FRY Partner Participation

Since 1997, USAID/Serbia has engaged in partnerships with US and indigenous NGOs to support an energetic and committed group of partners in Serbia realizing their vision of a democratically-governed FRY and Serbia. USAID focused on efforts to aid 13 DOS-controlled municipalities and to support indigenous non-governmental organizations (NGOs), independent trade unions, democratic political parties and coalitions, and independent media so that they could better defend their human, civil and political rights, advance the cause of non-violent democratic change and lay the essential foundation for their nation's democratic and economic transition. Emphasis also was placed on the provision of food assistance through an American NGO, to demonstrate that, although the United States was opposed to the policies and practices of the Milosevic regime, it supported the people of Serbia.

In the months before Serbia's historic September 2000 elections, USAID and its US NGO partners provided extensive support to a broad array of democratic opposition groups. A USAID-supported get-out-the-vote drive united the efforts of youth movements, human rights NGOs, independent trade unions, and democratically-oriented political parties in mobilizing citizens. The Democratic Opposition of Serbia (DOS), an 18-party coalition, took power after riding this popular wave of support from the polling booth through the tense weeks that followed, until on October 5, 2000 citizens took to the streets to demand that DOS' popular victory be recognized.

In both the September and December elections, USAID/FRY demonstrated its ability to assess, design, and implement effective pre-election strategies that focused on the

development of political parties, civil society NGOs, and independent media. USAID assistance partner NGOs supported indigenous civil society NGOs in their promotion of “get out the vote” campaigns, which resulted in a voter participation rate of over 70 percent. USAID partners also assisted indigenous watchdog NGOs, in conducting accurate exit polls, which proved to be critical in informing the general public of the attempted vote fraud by the SPS (Milosevic) and of the parallel vote count that demonstrated a DOS victory.

USAID’s portfolio was almost exclusively implemented via grants and cooperative agreements with US NGO partners including NDI, IRI, ACILS, IREX, Freedom House, German Marshall Fund, FDDR, IDEE, ABA/CEELI, and others. These organizations had the courage and flexibility to implement their programs even under extraordinarily difficult conditions that prompted three evacuations of the Embassy and USAID, the last of which in 1999 lasted 19 months. Their Serbian partners recognize these groups as having “been there” for them over the long-term. The relationships that have arisen out of these challenging circumstances have remained in the post-October 2000 period, and provide USAID and its partners with an extraordinarily high degree of access to key reform actors. To help our Serbian partners lay the foundations for democratic governance in the post-election period, USAID in FY 2001 extended many of its agreements with its US NGO partners. Programs were modified to address the new challenges of helping civil society organizations transition from an overtly anti-government role to a non-government one, and to assist DOS leaders in making the transition from opposition to democratically-oriented governance.

In late 2001, USAID initiated a \$200 million five-year citizen participation program, Community Revitalization Through Democratic Action (CRDA) implemented by five US NGOs. This project is stimulating democratic, social, and economic progress at the community level. In its first 90 days, the program engaged 297 communities spread throughout the country and implementation began on 343 projects. The main areas in which CRDA is working are civic activities, income generation, basic infrastructure, and the environment. The project priorities and implementation efforts are decided by community councils that are composed of a wide range of citizens, including representation of minority groups and women.

I. Environmental Factors

In August 2001, the Bureau Environmental Officer conducted environmental training for USAID-Serbia’s staff and the five NGO partners implementing the five-year CRDA program. At that time he pointed out that environmental concerns regarding tropical forests are not an issue since Serbia is not located in the tropics. In order to identify potential biodiversity concerns that must be addressed, USAID\ Washington has contracted with ??? and the results are attached and reflected as an addendum to the Interim Strategy submission.

PART II: FACTORS IN PROGRAM SELECTION

United States assistance to the Federal Republic of Yugoslavia (FRY) and its two constituent republics (Montenegro and Serbia) continues to be based on fundamental U.S. national interests. The FRY is a social, political and geographic crossroads between Western and Eastern Europe, Turkey, and Greece. Serbia has been the locus of instability in the Balkans since the end of the Cold War. After a decade of military and civilian involvement in seeking peace in Southeastern Europe, the U.S., NATO, the UN and the EU all have an enormous stake in stabilizing the region. The USAID-managed program directly advances ten U.S. International Affairs Strategic

Goals: regional stability; open markets; U.S. exports; global growth and stability; economic development; reduction of illegal drugs; counter terrorism; democracy and human rights; humanitarian assistance; and environmental improvement. The objectives USAID pursues in the FRY implement three of the goals under the Agency's Economic Growth, Agriculture and Trade Pillar ("broad-based economic growth encouraged", "human capacity built through training", and "environment protected for long-term sustainability") and the "democracy and good governance strengthened" goal under its Democracy, Conflict and Humanitarian Assistance Pillar.

Despite the dramatic electoral transition of 2000-2001, the FRY's democratic future is far from secure. In addition to resolving the status of Montenegro and Kosovo and other pressures for increased autonomy, leaders face the challenge of building broad consensus on a range of critical social, economic, and political changes necessary to move the country toward the global community of democracies. It is essential that constructive frameworks be developed for addressing lingering ethnic, religious, regional and economic concerns through peaceful, legal means, in order to avoid regression into defensive, violent nationalism. It is unclear whether the government's 18 party coalition will hold together through the next round of elections. Reforms must be moved through largely unreformed bureaucracies and a Byzantine system of pervasive grand and petty corruption.

The question of dealing with the past is of central importance in shaping the FRY's post-Milosevic national identity. Although Milosevic and some others were transferred to The Hague in 2001, publicly indicted war criminals remain in the region and attitudes toward efforts to bring Balkan war criminals to justice range from apathy, to support, to anger. Other human rights abuses, such as trafficking in persons, also remain to be addressed. In order to confront these challenges, mechanisms for citizens to participate in decisions that affect their lives and the development of their communities must be practiced and expanded. The foundation for democratic transition and consolidation (an independent judiciary, and sustainable NGOs and independent labor and media organizations) must be strengthened.

USAID vision is of a well-functioning, multi-ethnic society where there is reasonable expectation of an open market and economy coupled with a system of justice that is impartially administered and where there are opportunities for people to make informed choices and participate in their own social economic recovery. The Mission thus seeks to build synergies across three strategic objectives: economic policy reform, effective responsive and accountable democratic institutions and increased, better informed citizen participation in political and economic decision making. Developing the legal and institutional framework for an open market economy and a system of justice, as well as opportunities for citizen participation, are themselves essential to restoring normalcy for individuals, communities and the region.

In SO 2.1, the program is directed towards empowering communities to prioritize their own development needs, and to engage directly in addressing those needs through activities that increase the community's standard of living. This has a direct linkage to S.O 2.0, which will focus on engaging civil society more directly in the policy process; helping democratically-oriented parties connect more effectively with voters; supporting a competitive independent press offering objective information to citizens; strengthening the rule of law; and supporting free and fair political competition through elections. The employment and economic activities resulting from SO 2.1 investments also will cushion the short-term dislocations resulting from the economic reform supported under SO 1.3. SO 2.0 judicial and legal system reform efforts will also be key in building security and trust in the reformed economic system supported under

SO 1.3. Underpinning strengthened democratic systems and civic participation is a strong economy supported by the institutional, policy and legal infrastructure and strengthened private sector developed under SO 1.3.

PART III: Strategic Objective 1.3 - Accelerated Growth and Development of Private Enterprise

A. Statement of Objective

For the period covered by this interim strategy, USAID/Serbia's economic program will seek to create an open, competitive and efficient free-market economy. This will be accomplished through activities focused on stabilization, reform and restructuring, as well as Serbia's reintegration into Euro-Atlantic market and trading structures. These activities respond to needs highlighted earlier in this paper, specifically, an insolvent banking and financial system, a bankrupt enterprise sector, dilapidated regulatory and legal institutions, and near-complete isolation from world markets. The objective of all activities is to create enabling macro and micro-economic environments that are harmonized and consistent with EU policy, legislation and regulation, and which will "accelerate sustainable growth through the development of private enterprise". All activities shall seek to position the country for ultimate accession into the European Union, and thus will be coordinated with the European Commission and European Agency for Reconstruction. Results will be denominated in terms of growing gross domestic product (GDP) and exports, as well as increasing employment for both men and women. Some of the specific indicators directly impacted by USAID's activities will be greater private sector share of GDP, higher foreign direct investment, and increased investment as a percentage of GDP.

USAID/Serbia will lead or participate with other donors in promoting and implementing broad reform of financial, legislative and market infrastructures. The focus will be on strengthening institutions necessary for sustained implementation of structural economic reform measures, in order to quicken the transition from a socialist to a market economy. This also is critical to reducing incentives for corruption. USAID will work with and through FRY and Serbian counterparts in the executive, legislative and judicial branches of government; with NGOs; and other USG departments, notably the Departments of State, Treasury and Agriculture.

This strategy is premised on the belief that a growing economy and increasing employment and income is essential for peace, stability and deepening of democracy in Serbia and the Balkans. To that end, it is critically important to front-load funding of USAID's economic reform program. The current FRY/Serbia government is led by a motivated group of economic reformers who want to move quickly. They have successfully stabilized the economy and established an impressive track record by implementing decisive and difficult reforms in the areas of monetary policy, tax, banking, privatization and energy. Pending and future reform initiatives will become increasingly vulnerable as painful economic restructuring and reform measures are implemented. USAID's assistance, thus, supports the government's highest economic priorities, and provides advice and expertise needed to sustain momentum in implementing reform. This front-loaded strategy will assist in laying the foundation of a stable, open and functioning market economy that is better able to sustain the competitive pressure of EU accession. At the conclusion of this interim strategy period, Serbia will be well on-track, moving towards graduation.

B. Problem Analysis

After ten years of Milosevic misrule, Serbia's economy was largely destroyed by autocratic and distortionary economic policies, by manipulative domestic political parties, by sanctions which severed market and trade links, and by embezzlement of state assets by government and its cronies.

The banking system comprises more than 50 licensed banks, many of which are insolvent as a result of directed lending to poorly managed and corrupt state-companies. Many of these banks will be consolidated or liquidated over the next several years resulting in layoffs and thus increased unemployment in the sector. Other systemic problems remain, though these are less the result of imminent liquidation/consolidation, and more the product of earlier governmental policies. In order to resurrect a banking system which provides capital for consumption and capital investment purposes, it is essential that laws be adopted and enforced through enhanced supervision which ensures prudential and sound practices. The advent of a handful foreign banks promises valuable liquidity for a small segment of international firms, but institutions providing increased financial intermediation for domestic businesses and households is imperative to building enterprise and employment.

Severe economic contraction and hyperinflation combined with pervasive mismanagement and corruption has left nearly all state enterprises insolvent and bankrupt. Investment virtually ceased during the decade of the '90s and thus industrial plant and equipment are dilapidated due to use, neglect and also asset-stripping. Though the wage rolls of these companies remain large, in reality, few full-time employees remain and this explains unemployment which hovers around 40 percent, among the highest in the region. Many in the FRY support basic needs through dissaving, remittances, home production of basic foodstuffs, and through "gray" market activity which now represents between 40-50 percent of GDP. Reintegrating these workers into the formal market structures by building a growing private sector is essential to future economic growth and stability.

Attracting investment in order to rebuild the FRY economy demands much-needed reform of the legislative and judicial systems. The government has demonstrated considerable will to draft and ratify new laws, though uncertainties regarding implementation and enforcement are among the most significant impediments to growth and investment in Serbia. Consequently, USAID is activities promote the drafting or amendment of EU-harmonized commercial and related legislation. This legislation will support the FRY's economic growth and development strategy, and will be enforced through USAID-supported efforts in judicial reform and strengthening.

In 2000, the rally to confront a common political enemy produced a large coalition government with a unified political and economic agenda. Though the economic paradigm advancing open and transparent markets remains robust, complex politics involving a cast of Federal and Republic actors now threatens the continuity, consistency and pace with which the reform agenda will advance beyond 2001. The winter of 2001-2002 will be critical, as privatization and liquidation begin, and as the pain of higher prices, particularly energy, will become more intense. It is imperative that the IFIs and donors coordinate and work vigilantly to address urgent political, economic and humanitarian needs while simultaneously sustaining efforts to motivate structural and institutional reform. It is also imperative that the Government communicate its message more clearly, disseminate information more

consistently, and include public participation in legislative and policy-making more actively. USAID programs will actively promote increased education and awareness, enhancing the government's capacity to develop a constituency and to sustain public support for the economic reform underlying private sector growth and development.

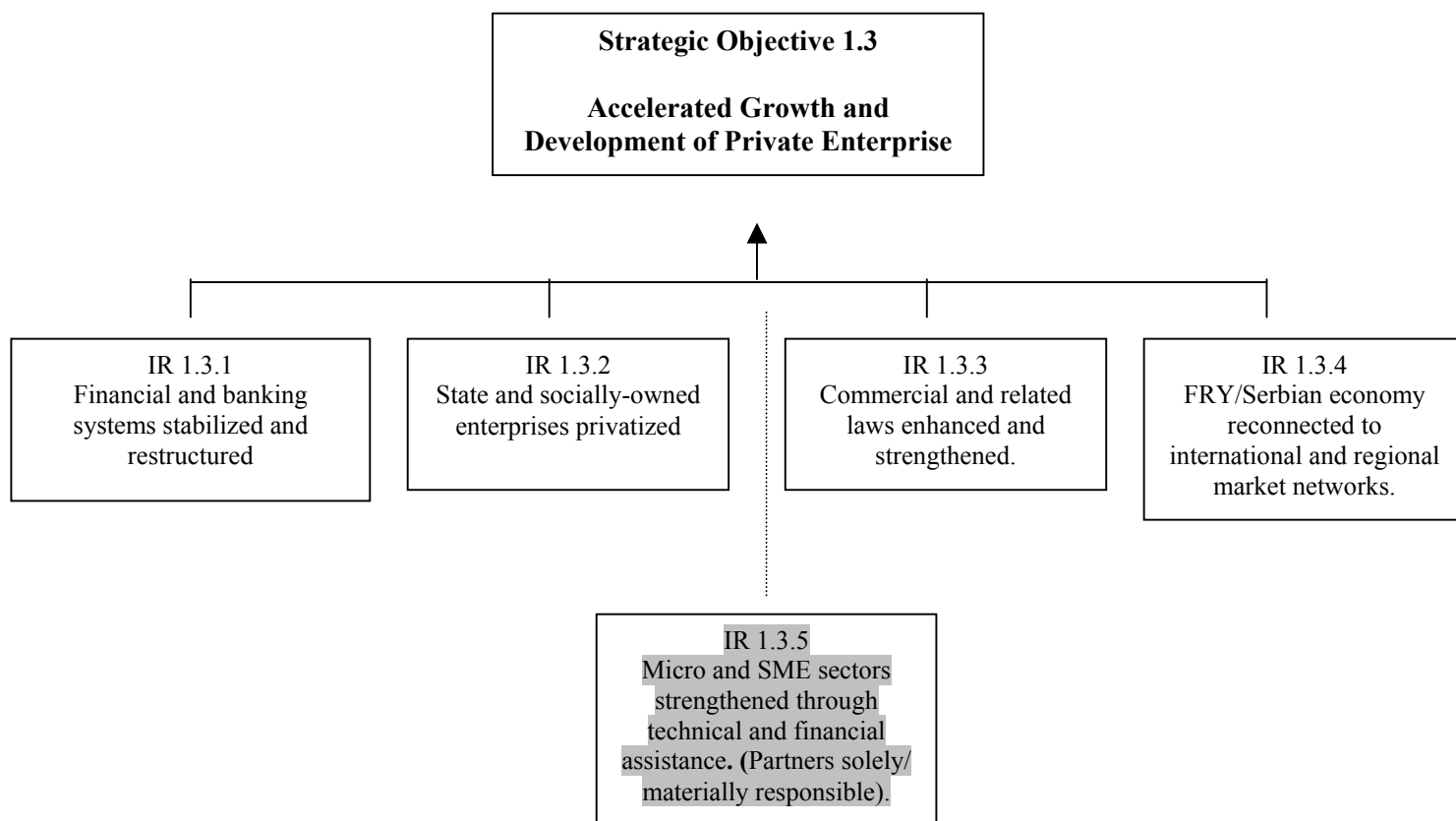
C. Results Framework

USAID's economic strategy is focused upon stabilization, restructuring and reform, as essential for peace and stability in the region and integration into Euro-Atlantic market structures. The objective is "*Accelerated Growth and Development of Private Enterprise*" by creating an open, competitive and efficient free-market economy, with results denominated in terms of increasing gross domestic product (GDP), exports, and employment (disaggregated by gender).

USAID will implement activities contributing to four intermediate results required to achieve Strategic Objective 1.3. All activities target structural weaknesses identified in the Economic Profile (Section B) and in the Problem Analysis above. Activities contribute directly to one or more intermediate result and all seek to position Serbia for integration into Euro-Atlantic economic and market structures. For example, without significant progress in commercial law reform and enforcement, increased financial intermediation and the resolution of bankrupt banks and enterprises will be impeded, if not obstructed. Success in achieving all four intermediate results is critical to establishing a market-oriented and business-friendly environment necessary which promotes investment and growth, and reduces the incentives for corruption, and integrates the gray market into the official economy.

Donor partners, notably the EAR and IFC/SEED, will implement a fifth intermediate result comprising specific micro and SME-related activities comprising direct technical assistance to enterprises, consulting firms and associations. . USAID will encourage these donors to collect gender-disaggregated data when possible. As noted above, activities that USAID is implementing under the other Strategic Objectives will have a significant impact on achievement of these IRs as well.

Results Framework



Note: See attached Results Framework with sub-Intermediate Results.

R 1.3.1 Financial and banking systems stabilized and restructured.

USAID is leading the donor effort to stabilize the banking system, and to establish a well-regulated, sound and functioning financial system. Under this IR, technical assistance will be mobilized to assist in isolating and resolving insolvent and illiquid banks in order to reduce and remove systemic risk. Conformity and adherence to international standards (Basle Core Principles) will be promoted, and new risk-based examination procedures will be introduced and adopted at the National Bank in both on-site and off-site supervision. Institutional capacity will be strengthened in all domains of banking supervision and policy. Bank intermediation will be promoted through the establishment of a model Mortgage Finance/Home Equity Bank. The U.S. Treasury is also providing technical assistance in problem bank resolution.

IR 1.3.2 State and socially-owned enterprises privatized.

USAID will work with the Serbian Ministry of Economy and Privatization and the Privatization Agency (PA), and other related or relevant ministries, to advance and implement transparent and competitive procedures to transfer ownership of state and socially owned enterprises through privatization, restructuring and/or liquidation. USAID technical

assistance will focus specifically on the development and implementation of restructuring strategies for approximately 30 firms identified by the PA.

IR 1.3.3 Commercial and related laws enhanced and strengthened.

USAID commercial law and judicial experts will work with host-country and donor experts to draft, implement, and enforce commercial legislation essential for a free and open market economy. Particular effort will be invested in those areas of commercial law, which protect creditor and investors' rights, and which expedite the adjudication process, either through the courts or via non-judicial means. This work will include policy formulation and implementation targeting disclosure in an effort to promote transparency and combat crime and corruption. Activities implemented under this Intermediate result will also include substantial public awareness and education in order to build and sustain a constituency for economic reform.

IR 1.3.4 FRY/Serbian economy reconnected to world and regional market networks.

The FRY and Serbian leadership are committed to WTO membership as well as accession into Euro-Atlantic market structures. USAID will assist in moving the FRY towards WTO membership, which will result in the following benefits: (1) full integration into the world economy and the multilateral trading system; (2) secure, open, and non-discriminatory access for Yugoslav goods and services to WTO member-country markets; and (3) the establishment of a transparent, stable, and predictable trade and investment climate. In addition to WTO membership, USAID will seek to position FRY/Serbia for eventual accession into the European Union.

IR 1.3.5 Micro and SME sectors strengthened through technical and financial assistance (to be implemented by partners).

USAID's activities in banking, privatization, and commercial law reform are critical to establishing an environment that supports SME development. However, USAID's economic strategy for SME development is pinned to the efforts of other donors' that are together providing more than \$150 million in technical and financial assistance in this area. The EAR's \$20 million will create an SME agency and law, establish a half-dozen business advisory centers, and capitalize credit lines in local banks. The IFC's \$33 million Southeast Europe Enterprise Development (SEED) effort will provide firm-level technical assistance, and will support associations and consulting firms. DFID, GTZ, KfW, and others are establishing credit lines in local banks. The EBRD has launched a \$65 million working capital line, and was part of the consortium that established the Micro Finance Bank (MFB) that was licensed in April 2001. (See discussion of mortgage finance/home equity bank below for a description of how that activity also will assist SMEs.)

D. Critical Assumptions

The following critical assumptions are made in assessing this SO:

- Serbia's government will remain democratic and committed to an open economy.

- Public support for reform will be sustained after the onset of bank and enterprise restructuring and liquidation, despite resulting short-term increases in unemployment.
- Serbia's government will advance a credible and adequate social package comprising severance, pension and other benefits payments in order to ease the impacts of stabilization and restructuring.
- The FRY and Serbian governments will sustain their commitment to open and free-market policies, the introduction and enforcement of the rule of law, and the identification and prosecution of crime and corruption.

E. Progress to Date

- A year ago, the FRY was not a member of any international financial organization. It is now a member of the IMF, the World Bank and the EBRD. It has successfully implemented its IMF Standby program and has entered into a consolidation loan program with the World Bank to clear arrears. It has also entered into a Succession Agreement with the other former Yugoslav republics to divide assets. In mid-November it successfully negotiated the restructuring of \$4.8 billion in Paris Club obligations. With bright prospects for a similar reduction of London Club obligations, the overall result will be a substantive reduction of outstanding debt.
- In late 2000, the FRY economy had widespread price controls, as well as restricted trade and access to foreign exchange. By mid-2001, almost all prices (excluding bread, flour, and utilities) were liberalized. The National Bank of Yugoslavia (NBY) imposed strict stabilization policies, abolished multiple exchange rates in favor of a managed float, and introduced currency convertibility. This has contributed to 4% real growth, a significant increase in international reserves, and a decline in annual inflation from 100% in 2000, to less than 50% in 2001. The government has brought the fiscal situation under control, in large part through the enactment of significant tax reforms and tax regime simplification.
- The NBY has taken decisive steps to stabilize and restructure the banking system. On June 15, 2001 the four largest banks were put into the Bank Rehabilitation Agency (BRA). The NBY and BRA Supervisory Board have since determined that all four will be liquidated early in 2002. In late September 2001, the NBY placed three more banks into the BRA, and brought six banks under special supervision for rehabilitation. Two more were intervened, de-licensed and are under special administration in preparation for liquidation.
- As a testament to the Serbian government's commitment to fight crime and corruption, the Ministry of Economy and Privatization (MOEP) broke-off negotiations initiated under the Milosevic regime for the sale of three cement companies. International financial and legal advisors were recruited in a competitive and transparent tender, and the sale of the three firms is now underway according to World Bank tender procedures. Batch tender procedures have been launched for 28 companies, grouped in four to six-company pools, each of which is managed by internationally recognized financial and legal advisors recruited according to World Bank tender procedures.
- A comprehensive trade liberalization program has been advanced, and the FRY's request for full accession to the WTO under Article XII of the Marrakesh Agreement was

approved by the WTO General Council. The FRY now has WTO observer-status. A working party has been established in Geneva, and a local WTO Accession Committee has been convened under the leadership of Dr. Miroljub Labus, FRY Deputy Prime Minister/Minister of Foreign Economic Relations. The FRY is committed to WTO membership as soon as possible, and it intends to submit its Memorandum of Foreign Trade Regime in early 2002.

F. Program Approaches

USAID will sustain and build upon initiatives launched early in 2001 following the election of the reform-minded coalition government. USAID activities will be implemented with key counterparts in the legislative, executive and judicial branches of government, with domestic non-governmental and private organizations, and in close cooperation with multilateral and bilateral donors. The focus on strengthening key institutions, e.g., the National Bank of Yugoslavia, the Ministry of Finance, the judiciary, and local think-tanks, is critical to promoting a comprehensive, coherent and sustained economic reform program. Perhaps more importantly, such institutions are essential to ensuring full-scale implementation of reforms. Efforts focused on stabilization and restructuring will produce broad economic and social benefits. Activities centered on integration, including the establishment of a Mortgage Finance/Home Equity Bank, will contribute directly to job creation, and these results will be tracked and gender-disaggregated to the extent practicable.

Stabilization

USAID's approach is to deliver substantial technical assistance in target areas that integrate critically important sectors underlying stabilization, restructuring and the reconnection of market and trade networks. As a first step in the process of economic reform, stabilization comprises both financial and enterprise sector initiatives. USAID is providing technical assistance to the National Bank of Yugoslavia, the Bank Rehabilitation Agency, and the Ministry of Economy and Privatization. These three institutions are central to the resolution of the bankrupt financial and real sectors. This tactical decision places USAID at the center of what is a complex economic, political and social puzzle.

Reform and Restructuring

Economic restructuring begins with the stabilization effort. It is based upon the reform and construction of legislative and judicial infrastructure supporting the rule of law, particularly in the commercial/economic sphere, and in which policies, laws and regulations are harmonized with European norms. Strengthening the institutions that draft, implement and enforce laws is critical to creating an enabling environment that facilitates new business development and ensures transparency and predictability in the conduct of business and commerce. Such an environment will further assist in protecting equity capital and will support increased financial intermediation for consumer and investment purposes.

USAID will build upon pre existing and planned commercial laws and related judicial activities to include elements that promote disclosure, transparency and compliance with tax and other laws, as part of the overall effort to reduce financial crimes and corruption. In addition, the USAID program will seek to elicit increased public participation into the policy formulation and legislative processes, and to better disseminate economic and related

information to the general public in order to educate, raise awareness, and build a solid constituency for reform.

Integration

As an original signatory to the General Agreement on Tariffs and Trade, Yugoslavia has a historical precedent of open markets and free trade. USAID will capitalize on this legacy, seeking to motivate membership in the World Trade Organization (WTO) and accession to other Euro-Atlantic structures at the earliest possible dates. WTO membership will permit the country to fully exploit its economic capabilities and potential, attract investment capital/technology/know-how, and facilitate economic recovery, development and sustainable economic growth.

Mortgage Finance

Finally, USAID will seek to establish a mortgage finance/home equity bank that will yield macro and micro-economic benefits in the short and long-term. At present, no domestic or foreign bank offers mortgage loans, nor are there plans to do so. According to a recently-completed study, Yugoslavia has no significant history of mortgage finance. Because US-established mortgage and home equity finance facilities are well known in central and southern Europe, the proposed Yugoslav Home Equity Bank is particularly opportune and appropriate.

The facility will promote financial intermediation that will increase access to housing, thus easing some social pressures. New construction utilizes locally procured goods and services, and is therefore immediately beneficial to domestic businesses. From experience, upwards of 60% of home equity loans are invested in small and medium enterprises, thus providing a conclusive and direct link to the SME sector. Regardless of whether home equity funds are used for new construction or for SME investment, the result is economic growth and job creation for men and women.

G. Development Partners

USAID will implement its economic activities with and through key governmental and non-governmental counterparts. Governmental counterparts will include relevant ministries and agencies at the Federal and Republic levels. Non-governmental counterparts include think tanks, associations, chambers of commerce and others engaged in economic and private sector-oriented activities. USAID will continue to coordinate its efforts with those of the U.S. Departments of Treasury and Commerce.

USAID also coordinates actively with the World Bank and the International Monetary Fund, and has contributed to the formulation a viable and coherent reform program. In addition to these two multilaterals, donors with which USAID works the most closely are the European Agency for Reconstruction, the European Bank for Reconstruction and Development, the Department for International Development (UK), KfW and GTZ (German) and Swiss Development.

H. Sustainability

USAID's ability to produce results under Strategic Objective 1.3 will be contingent upon sustained economic and political stability characterized by ongoing commitment to free, open and transparent markets. The government's ability to sustain reforms will be predicated upon its ability to surmount short-term but significant obstacles associated with the social impacts derivative of bank and enterprise privatization and liquidation, persistently low wages, and increasing energy and other basic costs. A goal of USAID's front-loaded economic assistance activities is to ensure that the government can manage this process effectively, and in so doing increase its credibility to accelerate and deepen the reform process.

The government's economic policy, strategy and tactics are sound. It has taken convincing steps towards fundamental and profound restructuring. Commitment to free and open markets is evidenced by currency and price liberalization and preparation for the imminent submission of the Memorandum of Foreign Trade Regime, which will thus christen the beginning of WTO membership proceedings. If, in addition, IFI support remains steadfast, and if social pressures are held in check, then the foundation that is being laid by the current government will provide a firm basis for future growth and employment generation, indispensable for domestic and regional peace and stability.

PART IV: Strategic Objective 2.0 - More Effective, Responsive, and Accountable Democratic Institutions

A. Statement of Objective

This strategic objective seeks to bolster the prospects for democratic transition and consolidation in Serbia by focusing attention on the institutions most critical as advocates for reform, movers of public opinion, channels for peaceful political competition, and centers of conflict resolution. These include civil society organizations that represent citizens' interests in the reform process and reduce barriers that divide Serbian society; a vibrant independent press able to hold its own as a skewed media market gradually opens to competition and to provide citizens with objective perspectives on critical societal issues; a legal system capable of delivering impartial justice; and, over the life of this strategy, a track record of elections that preserve free political choice through fair competition. This strategic objective balances attention to shoring up the most critical centers for reform within government with a recognition that Serbian civil society continues to be critical to advancing the scope, pace, and depth of democratic transition.

B. Problem Analysis

The landmark elections that brought DOS to power in 2000 marked the beginning of a new political era in the FRY. Civil society, independent media, and independent trade unions led a popular movement for change that resulted in this remarkable transition. USAID provided considerable support to this movement. This assistance was indeed a significant catalyst for democratic change in the pre-election period and beyond. In the past year, the political and social climate has improved markedly in several key areas, but has remained static in others. The most noticeable positive change for citizens is in the overall political climate. When asked what has changed most since October 2000, many Serbs answer that they no longer

“look over their shoulders”-- a key sign that the cloud of repression ever-present during the previous regime has lifted.

Despite this markedly less repressive atmosphere, the situation has not improved as rapidly as anticipated in several key aspects of the democratic transition. Inadequate, unsupportive legal frameworks hinder NGOs and independent media. The judiciary, police, military, and the civil service are largely unreformed. Key laws central to the democratic transition process in Serbia, such as a long-awaited law on local self-government that could initiate a reversal of the recentralization of government that Milosevic spearheaded -- have not been enacted.

Democratically oriented political parties have not come together to advance a clear policy agenda. Nor have citizens been involved sufficiently in developing those individual policies they have advanced. Politicians do not communicate the decisions they have made in a coordinated, effective manner. Polling data show that significant numbers of the electorate are tiring of the constant infighting and the resulting inertia that has characterized DOS during its first year in power. Were elections held in the near future, democratically oriented parties would still likely be elected, but by a thinning margin of voters. In sum, the stakes are high, and the window of opportunity for democracy is closing.

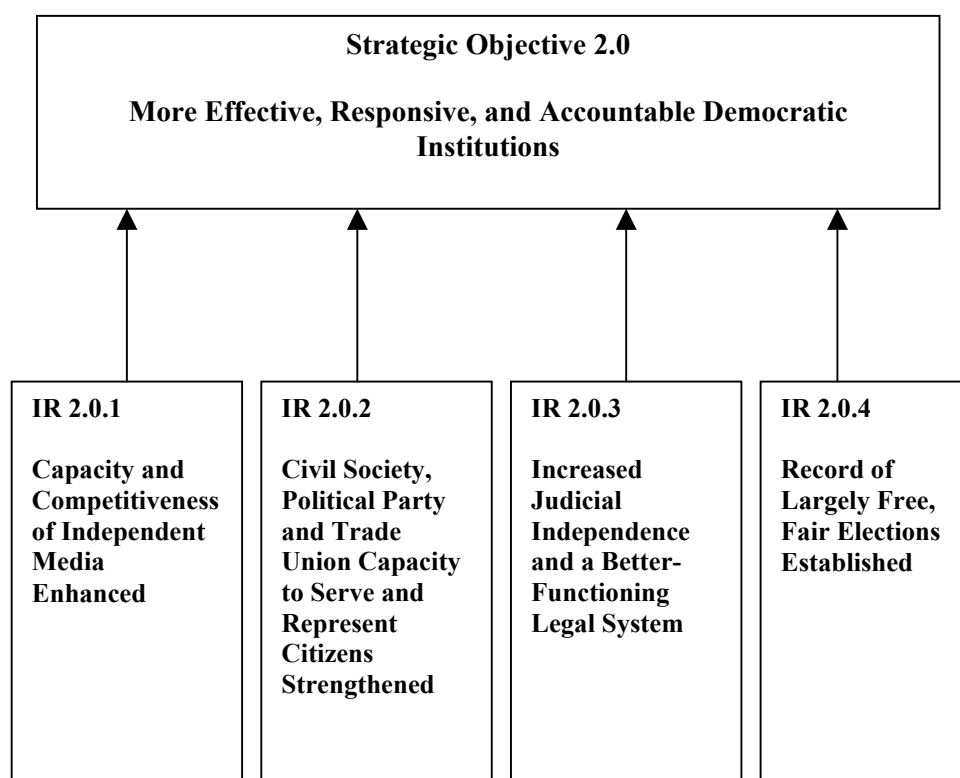
It is essential, therefore, that USAID provide sustained support to both non-governmental and governmental political and societal actors to build a more solid base of support and an institutional framework for Serbia's democratic future. The DG activities to be supported under this interim strategy do not differ markedly in scope from the program USAID has had in place leading up to and since Serbia's pivotal elections. The institutions we are currently supporting remain critical if we are to help keep the democratic window open, and to open it wider. Programs under this SO also directly address two key impediments to reform that are eroding prospects for lasting political change in Serbia -- corruption, and the potential for renewed conflict. (See discussion under Part I-D and F above.)

C. Results Framework

This strategic objective is supported by four intermediate results (IR): IR 2.0.1, Capacity and Competitiveness of Independent Media Enhanced; IR 2.0.2, Civil Society, Political Party, and Trade Union Capacity to Serve and Represent Citizens Strengthened; IR 2.0.3, Increased Judicial Independence and a Better-Functioning Legal System; and IR 2.0.4, Record of Largely Free and Fair Elections Established.

Progress toward achieving this strategic objective will be measured by tracking citizen attitudes towards the transition process, by assessing Serbia's Progress in developing a sustainable, constituent-focused NGO sector, and through performance indicators developed for each activity. Public opinion polls, the E&E Bureau's annual NGO sustainability index and other measures, such as ABA/CEELI's annual judicial independence index and Transparency International's annual comparative index on corruption, will be used to gauge progress.

Results Framework



IR 2.0.1 Capacity and Competitiveness of Independent Media Enhanced

Support to independent media remains a critical element of building broader consensus for democracy in Serbia. Key TV and radio outlets such as B-92 and other members of the ANEM network, and newspapers and weeklies such as *Danas* and *Nin*, have demonstrated that they are much more able than state-financed and entertainment-focused outlets to deliver quality, objective reporting on critical political, societal, and economic issues. The enabling environment and competitive playing field for independent media are developing more slowly than expected, however, and a new, privileged relationship has emerged between the new political elite and publicly owned RTS and a select group of commercial stations and papers.

Activities under this IR will include sustained attention to developing a more professional independent news media through training, institutional capacity-building, and limited donations of equipment; continued support for access to legal resources and comparative perspectives to inform media policy, and for effective independent media advocacy through networks; attention to developing independent media outlets as commercially-viable, business minded entities to prepare them for a market-oriented future; and continued support for local press to cover the Hague proceedings.

While the focus under this IR will be on independent media, we are and will continue to provide limited technical assistance and training to selected state media outlets, particularly radio stations. State radio does not receive significant levels of assistance from other donors, is a major source of news across Serbia, and is less subject to political manipulation than state

television. Further, its quality and level of objectivity have significantly improved and could continue to with limited support from USAID.

IR 2.0.2 Civil Society, Political Party, and Trade Union Capacity to Serve and Represent Citizens Strengthened

Civil society organizations played a key role in the dramatic exchange of political power from Milosevic's regime to DOS with an unambiguous declaration and demand for political change. They continue to be a critical in driving the political agenda and pushing for democratic consolidation. Activities under this IR will support Serbia's NGO sector and political parties in developing sustainable capacity to set clear political and social agendas and priorities that reflect citizens' preferences, and to work as advocates and partners in addressing critical social issues. USAID-supported NGOs assist communities and individual citizens in articulating their needs and priorities to all levels of government, pressing political leaders to respond with concrete proposals and actions, defending and applying their rights, and monitoring government performance. USAID will also support civil society efforts to form and maintain partnerships with government that build an inclusive society, create positive change, and manage the social effects of political and economic reform. Attention will be placed on increasing the NGO sector's long-term viability through capacity-building assistance to individual organizations, NGO service providers and resource groups, and to informal and formal NGO networks. Linking NGOs in Serbia with their counterparts elsewhere in the region to promote exchange of experience and lessons learned, and to engage in cross-border cooperation, will be an important component of this IR. Independent trade union activity will be supported under this IR as a critical complement to the mission's economic transition activities. Support for former state unions will also be considered as openings for reform in these unions widen.

Sustained support to democratically oriented political parties will center on building parties' capacity of parties to represent their constituents effectively, to engage citizens in all aspects of the policy process, and to communicate policy messages clearly to the electorate. Attention will be placed on developing women and youth leaders to take these parties into the future. Assistance in this area remains critical as the success of Serbia's democratic and economic transition depends on the ability of the parties to get the reform job done as effectively as possible without alienating citizens in the process.

IR 2.0.3 Increased Judicial Independence and a Better-Functioning Legal System

The reform challenges faced by Serbia's legal system can be traced to an almost ten-year legacy of direct and indirect assaults upon the integrity and independence of the judiciary and other components of the legal system. Although the system remains largely unreformed, there are encouraging signs that Serbia's judiciary could emerge from this legacy as an independent and vital institution. To strengthen the rule of law in Serbia, USAID will focus on building the capacity of legal sector institutions to effectively and transparently formulate and implement critical laws and systemic reforms, including: (1) a framework of laws that provides the basis for protection of essential human, political and economic rights; (2) a strong, independent, and accountable judiciary and a well-functioning court system; (3) active, independent bar and other professional institutions essential to the proper functioning of the legal system; and (4) strong and active civil society organizations (including judges' and bar associations, as well as legal reform-oriented NGOs) in a position to press for and monitor legal system reforms and human rights issues. The judiciary and the court system

will be the primary targets of USAID's assistance in this sector for the life of the strategy. Emphasis will be placed on helping Serbian institutions implement the package of five laws on the courts passed in 2001. Assistance to human rights organizations in truth and reconciliation-related activities will be provided both under this IR and under the civil society IR. This will not, however, be a major program focus, as other donors and USG agencies are providing a significant amount of support in this area.

We will also support limited capacity-building efforts that seek to develop the Republic-level parliament's capacity to develop as an independent, well-functioning branch of government. We are providing initial assistance to key parliamentary committees as part of ongoing political party interventions, and intend to monitor the progress of that activity closely as we assess opportunities for further support to parliament in the future.

IR 2.0.4 Record of Largely Free, Fair Elections Established

Elections at the federal and republic levels may be scheduled as early as fall 2002, and will be a critical factor in determining the future direction of Serbia's transition. USAID will provide support to non-governmental organizations and democratically-oriented political parties in building solid constituencies in favor of continuing on a democratic path, mobilizing these voters in the pre-election period, and to specific elections-related efforts designed to ensure a free and fair process (e.g., domestic monitoring and assistance to improve elections administration). Assistance to the next round of federal and republic-level elections is critical and will receive significant support under this strategy. Support for other elections during the life of this strategy will be assessed on a case-by-case basis.

D. Critical Assumptions

The following critical assumptions are made in assessing this SO:

- FRY and Serbian governments will continue to advance economic and democratic reforms and make progress towards integration with Euro-Atlantic institutions; governments will mitigate the social impacts of these reforms by implementing an adequate package of social benefits.
- Over the life of this strategy, and preferably within its first phase, current inadequacies in the legal framework and enabling environment for NGOs, independent media, and local government will be addressed; without improvements in these areas, sustainability in both sectors will be threatened.
- Conflict triggers identified in Part One of the Mission strategy will be taken into account by both government and donors to ensure that the transition is not derailed.

E. Progress to Date

- The US government and USAID's success in mobilizing DG assistance resources through a network of committed US and local partners to advance Serbia's dramatic political transition of October 2000 has been well documented.
- Since October 2000, USAID civil society assistance, both through the core mission program (and partners including NDI, IRI, IDEE, Freedom House, German Marshall

Fund, World Learning/STAR, FDDR, and others) and through OTI, has supported the NGO sector in transitioning from an anti-government to a vibrant non-government force for change through critically-needed grant support and capacity-building assistance. Examples of USAID and US NGO-supported NGO activities have included a successful YUCOM petition drive to reduce compulsory military service (a draft law is pending); an ongoing OTI-financed OTPOR anti-corruption campaign that is helping to raise awareness regarding key corruption issues; capacity-building assistance to OTPOR and CeSID, as well as financing for specific initiatives carried out by these two key NGOs; and core support to Civic Initiatives, a leading provider of NGO training for the Serbian NGO sector.

- Through USAID's support to IREX, key independent media players in the ANEM network (e.g., B-92), as well as key independent print publications and news service agencies have received both capacity-building training and targeted donations of equipment that have improved their ability to deliver the news to citizens. In addition, the project has launched a new component designed to ensure that the Hague process is covered by a rotating group of Serb journalists helping to demystify this process for their audience.
- USAID's agreement with ACILS has helped Nezavisnost develop as a vibrant voice in the social dialogue regarding Serbia's economic transition. The union provides a vital link between citizens and government regarding the planned privatization program and other economic reforms that will affect citizens' livelihoods. In recent months, Nezavisnost President Canak engaged PM Djindic and other key officials on amendments needed to the labor law that will ensure that workers are more informed regarding layoff decisions than previously anticipated under this law. Negotiations with the government regarding this law helped diffuse and shorten a general strike.
- A USAID-supported ABA/CEELI rule of law program has resulted in strengthening the Judges' Association as a key voice for judicial sector reform; jump-starting a multi-donor effort to establish a judicial training center; providing grant support to NGOs engaged in legal reform, legislative drafting, and human rights; and developing an effective gender in the law program; and launching a Southern Serbia legal initiative that helps to address ethnically-based employment discrimination issues through legal aid.

F. Program Approaches and Development Partners

The SO 2.0 program will be carried out primarily by US NGOs and consulting firms in partnership with numerous Serbian non-governmental organizations, independent media outlets, trade unions, democratically-oriented political parties, selected local governments, professional associations (e.g., the judges' association and the bar association), and with selected republican-level ministries and institutions (e.g., the judiciary, MOJ, and parliament). Programs will be coordinated with key multilateral and bilateral institutions engaged in DG assistance programs, with USAID's SO 1.3 (particularly on rule of law), and with OTI, which also funds a number of DG-related initiatives. Specific gender initiatives will be carried out under the civil society, political party, and rule of law programs; other DG activities will integrate gender in planning and reporting.

Media. Independent media support will be carried out by one or more US NGOs in partnership with Serbian independent media outlets, professional associations, and news

service organizations. Ongoing and planned activities include limited donations of equipment to boost capacity in target media outlets; training to increase journalists' capacity to report on key policy issues; support to stations and print publications in implementing more effective business management strategies; and a program of training and support to a rotating group of journalists reporting from the Hague regarding ICTY activities. There is a core group of donors providing support to media. USAID is the largest bilateral institution assisting this sector, and will coordinate with, among others, OSI and Press Now on media assistance activities. OTI provides support to media as well -- the core USAID program coordinates with OTI on its media initiatives.

Civil Society Support. To date, USAID's civil society program has been carried out by several US NGO partners that provide subgrants as well as capacity-building support to selected Serbian NGOs and independent trade unions. Under this strategy, agreements with some US NGOs will continue, while others will be successfully concluded. Early in the three-year strategy period, pending availability of funds, we intend to launch a new civil society initiative that will consolidate subgrant support and respond to capacity building needs identified by the sector (e.g., for advanced training in topics such as board development and constituency-building, as well as continued attention to improving the legal environment in which NGOs operate). We will seek to reduce the total number of civil society programs under this IR over time to ensure appropriate management oversight, but intend to maintain a consistent and relatively high level of support to this sector over the life of the strategy through these programs, as we consider supporting the development of a sustainable civil society sector a key priority over the three-year strategy period.

Grant making will be focused on policy, social, and rights issues of central importance to Serbia's democratic transition. In May 2001, USAID brought a group of leading local NGO and US partner representatives to Prague to discuss priorities for support to civil society and other sectors under the Mission's strategy. Civil society programs will directly support NGOs in carrying out activities identified in Prague as priorities, including youth development, strengthening NGO sector effectiveness, continuing to develop training capacity within the sector on a wide range of political, social, and NGO development issues (e.g., conflict mitigation, advocacy skills, sound NGO governance strategies, etc.), and leadership and civic education programs.

USAID is one of few civil society donors that prioritizes sector development via training in addition to grant making, as we believe this is an important niche in the civil society assistance arena in Serbia. Programs launched after the passage of anticipated republic NGO legislation, as well as expected future tax and labor laws governing NGOs, will take new requirements in these laws into account, e.g., by requiring that grant recipients register as specified under the law, regularize their banking operations, etc. We recognize that it is essential that donors begin to address these considerations in awarding grants after a prolonged period of providing grants to NGOs operating in legal limbo. Our support to civil society will be coordinated with other key multilateral and bilateral donors in this sector. OTI has provided extensive support to civil society in Serbia. We will continue to coordinate our civil society assistance with OTI to avoid duplication in programming and to ensure as smooth a transition as possible in assistance to this sector when OTI phases out its program.

Political Parties. USAID, in partnership with NDI and IRI, stands nearly alone in providing significant support specifically to democratically oriented parties. Other donors are providing assistance in some areas addressed by NDI's and IRI's party programs, such as support for an

improved legislative process, local government capacity building, and support to parties in policy development and outreach. We coordinate with other donors regularly and actively. IRI, for example, is coordinating with the World Bank on efforts to improve public outreach on critical policy initiatives. OTI, CRDA, and LGI are also key points of contact and coordination for these programs, as their local level activities are important complements. Polling supported by NDI and IRI is shared with the Embassy; selected portions of the polls are shared with top government decision makers (e.g., PM Djindic). Party assistance is undertaken within USAID's policy guidelines for this sensitive assistance area.

Support to political parties has and will include training for democratically-oriented parties in developing policy, communicating with citizens regarding policy, deepening and broadening constituencies, implementing more effective governance at the local level, and developing effective leadership (including women's leadership and youth leadership). Party programs also seek to build capacity in NGOs such as CeSID and OTPOR that contribute to a more vibrant policy dialogue and monitoring of government actions.

Rule of Law. In the first part of the strategy period, emphasis will be placed on increasing the capacity of government and NGO partners to formulate and plan necessary reforms. We will continue to support efforts to train judges, build capacity in key governmental and non-governmental legal institutions, address human rights issues in partnership with NGOs, and implement special initiatives focused on addressing specific rule of law issues (e.g., legal aid clinics that address employment discrimination issues in specific regions, and support for attention to gender issues related to ROL reform, such as domestic violence and trafficking). As time goes on, emphasis will shift to increasing the capacity of institutions within the system to implement new laws (such as the recently passed package of laws on the courts) and institutional changes, to the monitoring and adjustment of reforms on an ongoing basis, and to pilot efforts to reform the system in key areas such as court finance, case management, and improved court administration. USAID will coordinate its efforts with the numerous other international institutions (OSCE, EAR, UNDP, and OSI) and several bilateral donors engaged in rule of law support. We will also continue to monitor parliament's development as a legislative institution. We have begun an initial program of assistance through NDI that includes support to parliamentary committees and executive policy actors in improving the policy process; however, the time is not yet right to provide a more focused, longer-term program of support specifically directed at parliament. One of OTI's main priorities during its final year of programming is a public outreach effort aimed at building momentum for rule of law reforms. We and our partners are coordinating with OTI on this effort.

Elections. Election assistance will be provided largely through the political party strengthening activities described above. As Serbia's next round of federal and/or republic elections will be extremely critical in determining whether the country will continue along a democratic path, we plan to provide elections-related assistance in connection with these contests. Support for future elections will be considered, but is likely to diminish over time as Serbia establishes a "track record" of largely free and fair elections. As with political party assistance, election assistance is subject to legislative and policy restrictions. USAID and its partners will undertake election activities within these parameters. Strong donor coordination is particularly essential to ensure coordination vs. duplication of resources provided to NGOs, election commissions, etc. USAID will play an active role in ensuring that this coordination is as effective as possible.

G. Sustainability

Sustainability is a key goal of all activities under this SO. Civil society programs actively seek to promote greater sustainability by assisting NGOs in broadening and deepening their constituencies, establishing more effective systems for financial management and governance, and by exploring avenues for greater financial sustainability, e.g., through income generation activities. NGO financial sustainability is constrained by the overall economic situation in Serbia at present, and by the lack of clear tax and labor legislation affecting NGOs, but will remain a priority of USAID's civil society program over the life of the strategy. Progress in advancing NGO sector sustainability will be measured through annual reporting for the E&E Bureau's NGO Sustainability Index.

In media assistance, promoting a more competitive independent media sector is a direct goal. Not all independent electronic or print media outlets will survive a competitive media marketplace, nor should they. Our assistance seeks to ensure that media outlets are armed with the business skills to compete fairly in the marketplace, once an adequate legal framework that promotes transparent competition is in place.

In rule of law, sustainability depends on a long-term government commitment to judicial independence and legal system reform, including adequate and sufficiently independent court finance. This commitment is not yet strongly evident. We are closely monitoring progress in this area, as it will affect long-term prospects for sustainability of investments in judicial training, particularly through the newly established Judicial Training Center. In supporting this center, our first priority is to streamline the provision of badly needed training for the sector in the near-term. Sustainability is important, but is not a realistic goal for this institution at present. We, however, are limiting our investment in such medium and long-term judicial training initiatives until there is greater evidence that government is willing and able to commit its own resources to progress in this sector.

PART V: Strategic Objective 2.1 Increased, Better-Informed Citizens' Participation in Political and Economic Decision-Making

A. Statement of Objective

USAID promotes democratic processes and citizen empowerment at the grass roots level with the Community Revitalization through Democratic Action (CRDA) program and will support local government capacity to actively engage citizens as partners in community development through its local government program. These efforts will support tangible, meaningful opportunities for citizens to build trust and tolerance among ethnic and religious groups and achieve positive change in their lives and communities through direct participatory action and partnership with local government. USAID local government assistance programs will improve the management capacities of local governments and make them more accountable to the electorate. USAID activities under SO 2.1 will empower citizens to take an active role in creating positive change in their own lives. These activities will address inter-ethnic tensions, the negative social impacts of economic reforms, and frustration over the slow rate of improvements in the living conditions that communities face after twelve years of war, economic decline, and the deterioration of community infrastructure. The objective is to bring about "increased, better-informed citizen participation in political and economic decision-making".

Increased understanding and cooperation across community, political, ethnic and gender lines can be forged through tangible and positive experiences of engagement in collaborative community projects that resolve issues of common concern. Such cooperation can rehabilitate democratic and economic life in municipalities, reduce tensions along the dividing lines within communities, and develop improved leadership skills among women and ethnic and religious minorities.

Citizens will actively participate in local government decision-making and take concrete actions that result in immediate improvements to living conditions in their communities, generate new employment opportunities, and provide a de facto social safety net for vulnerable segments of the population. Local governments will establish transparent financial management and decision-making procedures and incorporate citizens and local NGOs into the process. Moreover, local governments will have the technical capacity to provide and maintain basic public services and infrastructure.

This strategy is intended to complement and support the national level political and economic reform and democracy programs contained in the other strategic objectives (SOs) of USAID/Serbia's strategy. By involving citizens in local decision-making, and strengthening the local governments, this SO will develop leadership skills, reduce tensions across community dividing lines, empower citizens to participate effectively in their communities, and demonstrate the tangible results of democratic processes that improve their economic opportunities, their lives and the well being of their families. As such, it will provide grass roots support for the reforms being conducted at the national level. Along with the other two SOs, this SO contributes to the mission's goal of bringing about rapid and sustainable changes within the country that will create an inclusive, democratic and prosperous society.

B. Problem Analysis

During the Milosevic years of the 1990s, the regime stripped local governments of most of their powers and financial resources. Because the opposition controlled the local governments of many urban areas, they were deprived of resources in an attempt to weaken and destroy their popular support. Elected on platforms that promised to improve living conditions, the reformers found that they had inherited a decaying infrastructure, paralyzed social service systems and coffers that were not only empty, but often deeply in by debt. Starved of funds, these municipalities had to neglect all but the most basic services. Worse, the new opposition leaders rarely had any previous experience in public administration and, hence, were poorly equipped to respond to the critical situations within their municipal governments.

At the same time, the people of Serbia suffered cycles of economic depression and social instability that resulted in severely decreased production, low wages and high unemployment. Gross domestic product dropped by over two-thirds and was accompanied by hyperinflation that reduced the value of financial assets. Economic decline, the lack of investment and the influx of refugees undermined the quality and capacity of social service delivery systems and institutions, such as the healthcare system and public utilities. Infrastructure deteriorated severely due to both a lack of investment and a social policy that subsidized public services to such an extent that the communal enterprises were unable to cover their costs of operation and maintenance. One result has been the collapse of the social safety net and an increase in the numbers of vulnerable people who are at risk and need assistance.

After years of an oppressive regime that severely suppressed democratic action and made endless empty promises, the population became apathetic and distrustful of the political process. Participation in political processes was seen as potentially dangerous and unproductive. Fed by the Milosevic controlled media, old ethnic and religious hatreds and distrust were rekindled and contributed to a further breakdown of community life. Recent polls have shown that the population remains distrustful of government.

Unemployment and underemployment remain unacceptably high and will increase in the short-term as economic reforms are implemented. Pensioners, refugees, IDPs and other vulnerable groups are in extremely precarious conditions and in need of immediate help. In addition, patience with the government is declining as people begin to doubt that the new democratic system will produce tangible benefits to the people.

To reverse this situation and restore democratic processes at the local level, CRDA will assist citizens in taking charge of the process of creating positive change in their own communities, actively participating in the identification of shared community priorities and needs, and designing and implementing projects to meet their own specifications. They will participate in all aspects of CRDA community development projects, learning to form networks across community dividing lines, and establishing partnerships with local government agencies and officials. They will learn how democratic and transparent decisions are made, how public projects are implemented, and using this understanding of government processes they will be able to establish new local traditions of government transparency, responsiveness and inclusiveness.

USAID local government assistance will support the establishment of new procedures and reporting mechanisms to inform citizens about how their government operates, assist local government in undertaking projects that meet community needs, and facilitate citizens in monitoring local government performance. Public hearings will be established to solicit citizen comment on budget priorities, community needs and improvements, and other operations of local government, empowering citizens and representative community organizations to shape decisions that immediately impact the quality of community life. Citizens will participate actively in local government decision-making and take concrete actions that will result in immediate improvements in the level and quality of municipal services and infrastructure.

These actions must be conducted on a nation-wide basis and benefit all segments of the population to negate the divisive and exclusionary practices of the past. The issues of unemployment, economically vulnerable people, deteriorating public services and unhealthy living conditions must be addressed now. If this is not accomplished, support for the fledgling democratic system and the economic and political reforms of the new government will be seriously undermined.

C. Results Framework

SO 2.1 Increased, Better-Informed Citizens' Participation in Political and Economic Decision-Making will be achieved through a two-pronged approach involving actions at the local level. An underlying theme to this approach is that democracy does not begin at the top. While reforms at the national level are necessary for democracy to flourish in Serbia, the success of such reforms ultimately depends upon the commitment of individual citizens to democracy.

Greater participation in public decision-making and local governments more capable of responding to citizens needs and priorities can help rebuild trust in institutions, support democratic processes, encourage stability in Serbia and the region, and support a climate favorable to economic growth and private sector development. To assure the support of the population for democratic practices and a continued agenda of reform, it is critical that citizens feel empowered to bring about immediate improvements in local living conditions and create new income earning opportunities. Hence, a major focus of this SO is on activities at the grass roots level and is reflected in the Intermediate Results.

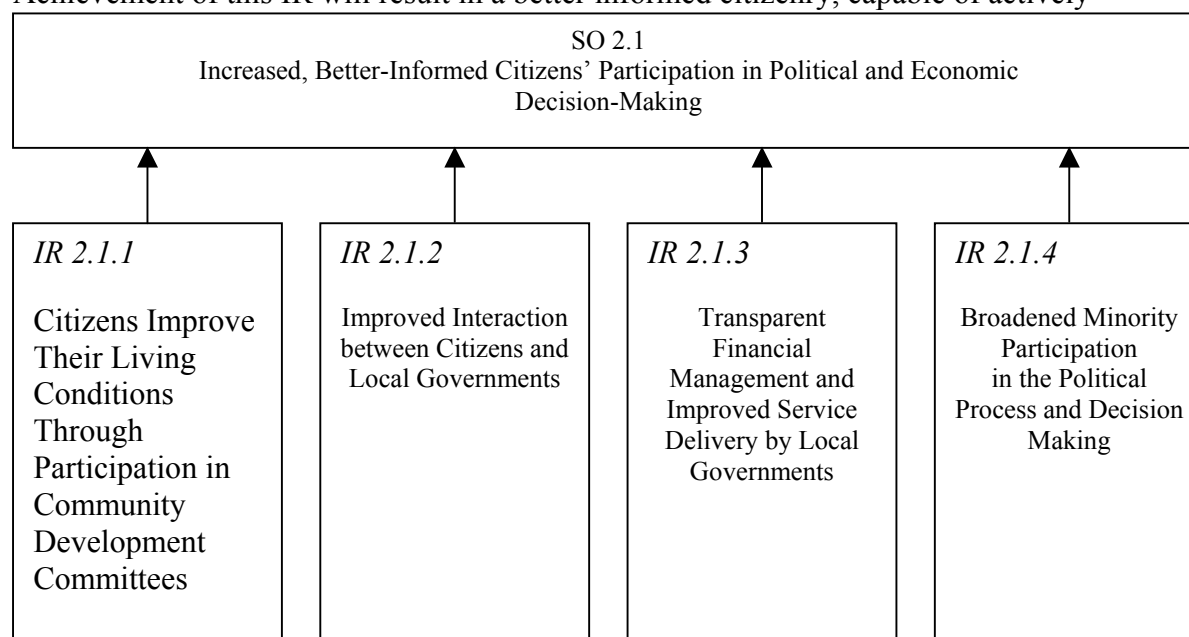
IR 2.1.1 Citizens Improve Their Living Conditions Through Participation in Community Development Committees

This IR will accelerate the process of social and economic recovery in Serbia through support for democratic actions by local communities. In order for a truly democratic society to emerge from the ruins of the Milosevic era, the people must be empowered to take an active role in decisions that affect their lives. This IR will assist in the creation and development of community development committees. Funding will be provided on a matching grant basis to these community development groups to ensure that they have a strong voice in the decisions and financing of local development projects. Through the work of these committees, this IR will demonstrate the efficacy of democratic processes and create informed and empowered citizens who participate in local decision-making on issues affecting their lives.

In order for life to improve and return to normalcy, the basic social and infrastructure needs of the population must be addressed as well as their employment concerns. By providing matching funds and involving the community in the decisions and financing of investments to improve infrastructure, generate employment and improve the environment, this IR will produce immediate results that will show that democratic processes and community cooperation can result in improved local living conditions. Consensus building will occur across community, ethnic, political and gender dividing lines.

IR 2.1.2 Improved Interaction Between Citizens and Local Government

Achievement of this IR will result in a better informed citizenry, capable of actively



participating in public decision-making processes in partnership with local governments that are more capable of communicating effectively with their citizens and better able to understand and respond to their needs. Citizens will participate in decisions about how public funds should be spent and will be able to monitor that public expenditures are made according to proper procedures, plans and priorities. This IR focuses on improving interaction between citizens and local government.

IR 2.1.3 Transparent Financial Management and Improved Service Delivery by Local Government

As a result of activities under these SO, communities will be better informed about municipal priorities and practices and better able to monitor government performance. Citizens will be capable of effectively participating in public decision-making, strengthening local governments' capacity to respond to citizen needs. When community priorities are addressed more effectively, it will result in tangible improvements in community life and economic opportunity, furthering grass roots democratic processes and maintaining support for continued political and economic reform.

IR 2.1.4 Broaden Minority Participation in the Political Process and Decision Making

To break down the isolation that exists between the different ethnic and religious communities within the country, this IR will, through the CRDA Program, support cluster projects that bring together the people from different communities, working together to solve a common problem. By providing a mechanism that induces these groups to work together, this IR will build trust among various communities and create a more tolerant and open civil society.

Many ethnic and religious minorities, as well as other disadvantaged groups such as women and the handicapped have often been excluded from community decision-making and have had their needs ignored. This IR will support activities to ensure that these disadvantaged groups are incorporated into the local decision-making process and have a voice in the selection of community development activities. By establishing procedures for the inclusion of disadvantaged groups into local decision-making processes and by requiring their recognition as legitimate members of the local community, this IR will contribute to their participation on a sustainable basis.

D. Critical Assumptions

The following critical assumptions underlay the activities of this SO:

- The Serbian Government will enact its proposed local government reform program, which will decentralize government and transfer authority and fiscal resources to the local governments that will enable them to fulfill their mandates.
- The financial resources needed to implement this strategy will be made available by the US Government.
- Peace will continue to prevail within the country.

E. Progress to Date

Grants were awarded on July 15, 2001 to five US NGOs to implement the CRDA Program. Each has been assigned a specific region of the country in which to work. As a result of a

very rapid mobilization, these NGOs had, by the end of September 2001, established approximately 300 community development committees in towns and villages throughout Serbia. Municipal elected officials, while at first somewhat uneasy with idea of directly engaging the citizens in community development activities, have seen the value of this direct participation and have enthusiastically supported the program. These officials are assisting to ensure that any necessary permits are swiftly provided.

Despite initial skepticism and distrust, the communities have enthusiastically responded to the program. Decision-making citizen councils have been elected that represent all elements of the local communities, including minorities, women and youth. These groups play an essential role in identifying, prioritizing and addressing the needs of their community through consensus building, out-reach and the mobilization of the required local counterpart contribution (25 percent of total project cost), thus building the foundations for a democratic society.

Investment priorities have been established and in the majority of instances the required 25 percent local counterpart contribution has been largely exceeded, averaging more than one-third of project costs. As of the end of December 2001, over 100 of the more than 300 projects of the initial phase were already completed. During 2002, it is anticipated that between 600-900 new projects will be undertaken with these communities. The wide coverage and rapid results of the program combined with its insistence on community participation have made CRDA one of the most visible and popular donor programs in the country.

The contractor for the Local Government Initiative began mobilization at the end of September and within two months had identified the first 25 of a total of 50 municipalities that will be included in the program to strengthen their management capacities. These municipalities are located in all regions of the country and include both large cities and small, rural municipalities. Assessments of the municipalities training and information technology needs are underway. Based on this information, work plans were formulated and implementation was begun in January 2002.

F. Program Approaches

SO 2.1 focuses on rebuilding the key elements of a democratic society. It is being implemented by American NGOs and consulting firms in partnership with local groups and the participating communities and municipal governments. The CRDA Program will redynamize grass roots democracy by demonstrating to citizens that they can empower themselves and improve their living conditions. Priority is being given to projects that produce immediate improvements to the local community, while concurrently laying the foundation for longer-term social and economic development. These projects include rehabilitation and construction of small and medium-sized infrastructure, such as electrical grids, water systems and minor road improvements that will assist in revitalizing the local economy.

With the requirement that all elements of the local society participate in the decision-making on community investment priorities, CRDA will help citizens of different ethnic and religious backgrounds work together to solve local problems affecting all of them. As they work together on common problems, an atmosphere of confidence and trust will be slowly rebuilt. Moreover, by supporting communities to mobilize resources and solve local development

problems, CRDA provides them with the opportunity to become agents of change, advocacy and development. In short, the CRDA Program will result in the creation of an empowered citizenry who demand accountability and transparency in government, complemented by the LGI Program which improves the capacity of local governments and establishes participatory decision-making procedures.

G. Development Partners

Support for grass-roots democratic action is wide-spread within the donor community, although most programs are small and of limited focus. The Italian, Swiss, German, French and British governments are all involved in programs to strengthen local governments and improve the local economies. The OSCE and the UNDP are also engaged in efforts to support improved local governance. Because USAID has the largest and only countrywide program, the other donors look to the mission as the lead donor and this has facilitated collaboration and coordination with the other donors. USAID/Serbia has been working with the Serbian Ministry of International Economic Relations to ensure also that donor program duplication and overlap do not occur. The mission also has been actively supporting the formation of an informal coordinating group with representatives from each of the donors who are funding local government and community development programs.

H. Sustainability

As communities see immediate and tangible improvements to their social and economic environment as a result of their participation in the CRDA Program, their commitment to work together will grow along with their ability to engage constructively in local government decision-making processes. The stress on participatory decision-making, transparency and accountability in the implementation of the CRDA projects will cause citizens to demand transparent local government procedures, citizen participation and accountability of their elected leaders.

With the implementation of the decentralization and local government reforms, the municipal governments will be better equipped to provide required basic services and infrastructure. Training and technical assistance provided to local leaders by the Local Government Initiative will make them better able to fulfill their responsibilities and ensure that their procedures are transparent, accountable and participatory. It also will show them how to work collaboratively with local NGOs to address local issues.

The combination of an informed, involved citizenry, an active local NGO community and a democratic, transparent, responsible municipal government will fulfill the key prerequisites for democracy to flourish on a sustainable basis at the grass-roots level.

PART VI: RESOURCE REQUIREMENTS

A. Program Budget

As the Country Team pointed out “current condition in the Federal Republic of Yugoslavia (FRY) present us with a historic opportunity to consolidate our recent success. The dramatic changes in Yugoslavia over the past 12 months, including the ouster of Milosevic and the initiation of fundamental political/economic reform, have been a major foreign policy Wednesday, April 17, 2002 Substantial near-term USAID support of the strategy detailed herein is essential if the governments and people of the FRY and Serbia are to stay the

course. Opportunities present in 2001, 2002 and 2003 will diminish as time passes. Delays in up-front funding by stretching-out our delaying resources to future years will not make up for those missed opportunities.

The US Congress already has signaled its readiness to be forthcoming to an inclusive democratic FRY and Serbia which is respectful of human rights, committed to international cooperation, and forthright in implementing needed reforms by increasing the SEED funding it is prepared to authorize by 15 percent between FY 2001 and FY 2002, respectively, \$100 and \$115 million, plus significant ESF financing for debt relief. Conversations have indicated a willingness to consider even higher levels over the short-term (e.g., \$125 million in FY 2003), as long as the commitments summarized above are maintained.

USAID's strategy for the use of resources is simple. Annually, approximately \$60 to 70 million are required to sustain the civic participation and local government strengthening activities of CRDA and LGI, including making up for the shortfall of nearly \$20 million in FY 2001 funding. An additional \$15 to 20 million are required to maintain, expand, and deepen intervention in the broader DG area. As made clear in this strategy, substantial support for the economic reform program (exclusive of emergency balance of payments or debt relief assistance) is essential if a growing economy and increasing employment critical for a peaceful, stable and democratic Serbia (and the Balkans) are to be maintained and strengthened. Based on the performance over the last several months in the economic reform area and current plans, we estimate that \$30 to 40 million per year will be required for this pillar.

Program Development and Support funding to support this strategy should average out at about \$3 million per year.

Barring the trigger events discussed in Part One of this strategy, we believe those resource levels will be required and warranted through FY 2004. After that time, it is likely the need for US support will decline significantly.

B. Operating Expenses

USAID restarted operations in Belgrade in October 2000, followed by the relocation of all mission personnel from Budapest in January 2001. USAID's current USDH staff of seven, however, did not all arrive until September. Although FSN staffing plans are fairly firm, almost two dozen people remain to be hired to bring the FSN staff up to its planned complement of 42. It probably will be late FY 2002 before there is sufficient actual cost data to firmly estimate OE resource requirements. Currently, we estimate OE resources to support the management of the portfolio and back-up USAID's office in Montenegro will average about \$2.8 million per year. This assumes only eight USDH employees, and that staff turnover costs and inflation replace high start-up costs in the budget. The Embassy also is staffing up and renovating the compound where USAID is co-located. As a result, ICASS charges are anticipated to continue to increase.

C. Management Plan

Between October 2000 and July 2001 USAID's core staff of one USDH, four USPSCs and five FSN employees was able to develop and implement the almost \$100 million program to support democratic and economic transition programs in Serbia. This was possible in large

measure thanks to strong technical, programmatic and moral support from USAID/W and RSC/Budapest. We anticipate having to draw on similar support throughout the period of this strategy, but especially through FY 2002. As summarized under Operating Expenses above, it will be several months before the mission is fully staffed. Agreements with several partners were completed late in FY 2001 and many still are gearing up operations and will not reach full stride until early 2002. In addition, new relationships must be established and existing relations modified to complete the transition to the new post- Milosevic USAID-FRY-Serbia relationship.

Nonetheless, experience indicates management concerns have not impeded results. The arrival of new implementation partners and full staffing of the mission will solidify those results and assure sound management of the activities that evolve from this strategy.